The Economist
Is GM on the recovery track?
PAGES 62-63
Should companies be "responsible"?
PAGE 53
Building democracy in Iraq
PAGES 44 AND 45
LIVING DANGEROUSLY
A SURVEY OF RISK, AFTER PAGE 48
JANUARY 24TH-30TH 2004
www.economist.com
A real Iowa surprise
US$4.95 · C$6.95

PRINT EDITION

Full contents
Enlarge current cover
Past issues/regional covers
Subscribe

GLOBAL AGENDA

POLITICS THIS WEEK

BUSINESS THIS WEEK

OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIEDS

DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds

ONLINE FEATURES
Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

The Economist Group
Economist Intelligence Unit
Economist Conferences
The World In
Intelligent Life
CFO
Roll Call
European Voice
EuroFinance Conferences
Economist Diaries and Business Gifts

Advertisement

Print Edition January 24th 2004

A real Iowa surprise
The Iowa caucuses brought a mixed result for George Bush, but a good one for America ... More on this week's lead article

The world this week

Politics this week
Business this week

Leaders

The Democratic primaries
A real Iowa surprise

Universities
Pay or decay

British courts
The probability of injustice

Cloning
Pregnant pause

Democratising Iraq
Go for the vote

North Korea's nuclear taunts
Don't be panicked

Letters

On AIDS, the war on terror, American universities, Colombia, crime, America's election

Special Report

Financing universities
Who pays to study?

United States

The Iowa caucuses
Who loves a winner?

Farewell, Dick Gephardt
The nearly man

The state of the union
In search of a theme

The electoral week
Primary colour

Voting machines
Good intentions, bad technology

Cowtown in the desert
A new sort of wind power

Lexington
Enter the general

The Americas

Bolivia's troubles
From here to 2007, without falling?

Mexico
Turtles in the soup

Central America
Capitalism in the raw

Canada's economy
The loonie flies too high

Asia

North Korea
Playing with plutonium

North Korea
Nasty weapons

Myanmar
Some peace, no development

India's politics
The unlikely heiress

Japan's press
Members only

China's property market
Castles in the sky

Previous print editions

Jan 17th 2004
Jan 10th 2004
Jan 3rd 2004
Dec 20th 2003
Dec 13th 2003

More print editions and covers »

Subscribe

Subscribe to the print edition
Or buy a Web subscription for full access online
RSS feeds
Receive this page by RSS feed

A survey of risk

Living dangerously
Freud, finance and folly
The price of prudence
Too clever by half
Financial WMD?
The missing market
Be prepared
Easy to lose
Learning to live with uncertainty
Acknowledgments
Offer to readers

Business

Corporate social responsibility
Two-faced capitalism

Hollinger's troubles
Triumph of the twins

Military aircraft
Boeing down, again

Counterfeit goods
Psst. Wanna real Rolex?

Russia's business rows
Meet the oleagarchs

European road tolls
Road rage

Business schools
MBAs for anoraks

Face value
Mr Protectionism's riskiest call

Special Report

General Motors
Cadillac comeback

Finance & Economics

Parmalat
Skimming off the cream

Italian corporate bonds
Fashion victims

Banking regulation
Hall of fame

Japanese shares
On the edge

Currencies
Talk is cheap

Economics focus
Canyon or mirage?

Science & Technology

Cancer modelling
Malignant maths

Treating cancer
A burning (t)issue

Gorilla conservation

China
Hitting the slopes

Middle East & Africa

Democratising Iraq
Elections or caucuses?

Human rights in Morocco
An Arab first

Arab education
The risks of reform

Angola
The shameless rich and voiceless poor

Uganda's Jews
Equatorial Torah

South Africa's war on AIDS
A slow march

Europe

Polish politics
Miller's crossing

Turkey
Coming to America

German tax reform
Systematic chaos

French driving
Speed, rules and psychology

Russia's president
Vlad the webmeister

European Parliament
Banana Union

Charlemagne
How to blow a trillion euros

Britain

Investigating child murder
The baby and the bathwater

The economy
The missing guest at Gordon's party

The minister for (self-) defence
The hardest word

Online retailing
Windows shopping

Second-hand Britain
Booting online

Bagehot
A little local difficulty

Articles flagged with this icon are printed only in the British edition of *The Economist*

Good news, for a change

Space policy
Hubble trouble

The Richard Casement internship

Books & Arts

Dealing with North Korea
Nuclear futures

McCarthyism
Naked truths

Medical research
Ego men

Biography
Rich man, poor man

New fiction
The way up

New York theatre
Curtain crises

Obituary

Kiharu Nakamura

Economic and Financial Indicators

Overview
Output, demand and jobs
Prices and wages
Immigration
Money and interest rates
The Economist commodity price index
Stockmarkets
Trade, exchange rates and budgets
Commodity prices

Emerging-Market Indicators

Overview
Current-account balances
Economy
Financial markets

Advertisement

Classifieds

Jobs
Head of Economic Affairs
The European Mortgage Federation is the voice of the housing finance industry at the ....

Business / Consumer
WSI Internet - Start Your Own Business
Business Opportunity - WSI Internet Start Your Own Busines....

Tenders
Republic of Ghana Ministry of Trade, Industry, PSD & PSI - Request for Expression of Interest: Feasibility study for the Establishment of a Free Port

Jobs
Senior Economist
Senior Economist (Northville) CSM Worldwide, an international automotive research firm,....

Business / Consumer
English Bulldog For Adoption
Top quality English Bulldog puppies available! The bullies are Champion....

Tenders
South African Development Community (SADC) NBFI Regulators' Capacity Building Programme
Request for Express....

Sponsors' feature

About sponsorship »

Copyright © The Economist Newspaper Limited 2006. All rights reserved. Advertising Info | Legal disclaimer | Accessibility | Privacy policy | Terms & Conditions | Help

Produced by =ECO PDF TEAM=
Thanks xxmama

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Politics this week

Jan 22nd 2004
From The Economist print edition

Iowa surprise

EPA

John Kerry won a surprise victory in the **Iowa caucuses**. The Massachusetts senator picked up 38% of the vote. John Edwards received 32%, pushing Howard Dean, who has hitherto dominated the race, into third place with 18%. Dick Gephardt, the party's former leader in Congress, ended his campaign after coming fourth.

See article: Surprise in the cornfields

President George Bush delivered his annual **state-of-the-union address** to Congress. In a comparatively low-key speech, the president defended his decision to invade Iraq and called on Iran and North Korea to end their nuclear programmes.

See article: The state-of-the-union address

Democrats reacted furiously to Mr Bush's decision to bypass the Senate and appoint Charles Pickering to the **federal court of appeals**, just a few days before Congress was due to begin a new session. Mr Pickering's nomination had been stalled by the Democrats' claims that the Mississippi judge has a poor record on civil rights.

Gateway of hell

A suicide bomber in a car killed at least 25 people, all but two of them **Iraqis**, outside the main gate to the area encompassing the Baghdad headquarters of the American-led Coalition Provisional Authority.

See article: Elections or caucuses?

The next day, the biggest demonstration since the toppling of Saddam Hussein was held in **Iraq's** capital, with at least 100,000 people, mostly Shia Muslims, demanding direct elections to a transitional national assembly rather than selection by caucuses, as proposed by the Americans. The United Nations agreed to send a team to Iraq to see if fair direct elections could be held in time to produce an assembly by the end of May, as the American timetable decrees.

See article: Democratising Iraq

Iran's President Muhammad Khatami and his reform-minded government threatened to resign unless the conservative Council of Guardians, the country's highest body, reversed its decision to ban about a third of the candidates, all reformers, from standing in next month's general election.

Prosecutors said they were considering whether to charge **Israel's** prime minister, Ariel Sharon, over alleged corruption involving a property developer and Mr Sharon's son, Gilad.

Israeli aircraft bombed two Hizbullah guerrilla camps in southern Lebanon. The raid came in retaliation for a Hizbullah missile attack that killed an Israeli on the Israeli side of the border.

At least 27 **Algerians** were killed by an explosion in Algeria's largest gas refinery, at Skikda. Foul play was not suspected.

South Africa's president, Thabo Mbeki, said that his **Zimbabwean** counterpart, Robert Mugabe, had agreed to start formal talks with the opposition Movement for Democratic Change. Meanwhile, Morgan Tsvangirai, the MDC's leader, appeared in court on treason charges.

Stay-at-home boffins

In an attempt to counter suspicion that Pakistan had helped North Korea, Iran and Libya with uranium enrichment, **Pakistan** barred all scientists working on its nuclear-weapons programme from travelling abroad. General Pervez Musharraf said Pakistan's nuclear and missile technologies were for national defence only.

A scientist who was in a private American delegation to **North Korea** told a Senate hearing in Washington that the North Koreans could probably make plutonium, but that he had seen no evidence that they could build a bomb.

See article: North Korea shows off its plutonium

EPA

The avian flu which has infected over ten people and killed around 1m birds in **Vietnam** may now have spread to **Thailand**. Health experts are concerned that the virus could become far more deadly.

Malaysia's court of appeal refused bail to Anwar Ibrahim, a former deputy prime minister who wants to seek medical treatment abroad. He was jailed in 1999 for corruption, later followed by sodomy charges in what was widely seen as a politically motivated trial.

The leader of **Japan's** main opposition party called for the resignation of the prime minister, Junichiro Koizumi, after the controversial dispatch of 1,000 troops to Iraq. The country's self-defence force will engage in humanitarian work only. But critics claim that the move contravenes Japan's pacifist constitution.

Lending a hand

The United States and Mexico convened a meeting in Washington, DC, to drum up aid for **Bolivia's** fragile democracy.

See article: Bolivia's new president

Officials from the United States and Costa Rica resumed final talks on a proposed trade accord. They hoped to complete them this month, to allow the **Central American Free-Trade Agreement** to go to the United States Congress for ratification.

See article: Free trade in Central America

A court in Lima began the trial of Vladimiro Montesinos, **Peru's** jailed former intelligence chief, on charges that he smuggled arms to Colombia's FARC guerrillas. Mr Montesinos has already been convicted of four lesser corruption offences; in all, he faces more than 60 charges.

Too strong for some

European Union finance ministers failed to stop the rise of the **euro**, even though several ministers expressed concern about its effect on their economies. Ministers were at least able to agree that the European Commission should practise more discipline over the EU budget.

See article: A sprinting euro pauses for breath

A bomb attack damaged the car of a newly appointed Muslim prefect in **France**. Aïssa Dermouche, who was chosen last week as prefect of Jura, is the first Muslim to get such a post in 40 years. The attack

came in the wake of street demonstrations against the French government's plan to ban the wearing of headscarves by Muslim girls in schools.

Transport strikes disrupted travel in **Italy** and **France**. In France, a one-day national rail strike brought chaos to the roads. In Italy, thousands of passengers were grounded by a one-day strike at the national airline, Alitalia.

EPA

Israel decided to attend a Swedish conference on genocide despite threats to boycott the event after the Israeli ambassador in Stockholm damaged an art exhibit that he said glorified suicide bombers. The Swedes pleaded freedom of artistic expression; the Israelis detected anti-Semitism.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Business this week

Jan 22nd 2004
From The Economist print edition

Banking on success

America's big banks enjoyed bumper returns in the fourth quarter. **Citigroup**, the world's biggest financial-services firm, announced that net profits had almost doubled compared with a year ago to $4.8 billion; **Bank One** saw profits rise by 16% to $978m; **J.P. Morgan Chase**, which recently agreed to buy Bank One, made $1.9 billion; **Wells Fargo** reported profits up by 10% to $1.6 billion; **Merril Lynch's** profits more than doubled to $1.2 billion; and **US Bancorp's** profits increased by 19% to $977m.

Black out

The secretive Barclay twins took advantage of the travails of Lord Black to acquire **Hollinger Inc** for $465m and hence a controlling interest in Hollinger International, the company that owns Britain's *Daily Telegraph*. The deal may face obstacles. American regulators are probing unauthorised payments of $32m from Hollinger to the troubled former media baron and other executives. Hollinger International may also try to block a deal done over their heads.

See article: Newspapers

Carlsberg, Denmark's leading brewer, offered *euro*523m ($660m) to buy Holsten, a German rival. Rumours of a takeover have pushed up Holsten shares. Carlsberg is keen to get its hands on the German brewer's distribution network in the leading beer-drinking nation, to increase sales of its own brands there.

Honeywell's attempts to avoid problems with asbestos foundered after it failed to sell **Bendix**, a car-part subsidiary with significant asbestos-related liabilities. Creditors of Federal-Mogul, a car-parts firm in bankruptcy protection since 2001 after collapsing beneath its own asbestos liabilities, was not prepared to take over Bendix's fresh liabilities of around $2 billion.

A long-awaited consolidation of America's mobile-phone market could be coming. **Cingular Wireless**, America's second-largest mobile operator, was reportedly ready to bid for **AT&TWireless** and create America's largest mobile service. Japan's **NTTDoCoMo**, which already owns 16% of the company, is also said to be mulling a bid for a firm worth some $30 billion.

Advancing technology?

Advanced Micro Devices offered evidence of a resurgence in the technology sector. The American chipmaker made a profit of $43m in the latest quarter, compared with a loss of $855m a year ago, after revenues jumped by 76%.

Motorola added to the cheer. The world's second-largest mobile-phone maker reported fourth-quarter profits of $489m compared with $174m the year before. Motorola also expects healthy profits in the next quarter as handset sales recover from a protracted slump.

Lucent Technologies gave less cause for optimism. Despite a second consecutive quarterly profit (of $338m) after a long period of losses, the world's leading telecoms-equipment company was more cautious about hailing a recovery in the technology sector.

Eastman Kodak, still struggling with the switch to digital photography, will cut its workforce by a fifth

over the next three years. Some 15,000 jobs will go.

General Motors announced profits of $674m in the fourth quarter (excluding the sale of Hughes Electronic for $1.2 billion), down on a year ago but ahead of expectations. GM sounded upbeat about its propects in 2004.

See article: Signs of recovery at General Motors

Courting popularity

Crowds of well-wishers cheered **Martha Stewart** as she arrived at court in New York to face trial on charges related to insider dealing. The American lifestyle guru denies the accusations.

Cheering crowds were notably absent as the trial began of six top bosses of **Mannesmann**, including the German company's former boss, Klaus Esser, and Josef Ackermann, Deutsche Bank's chief executive and erstwhile non-executive director. They are accused of illegally paying generous bonuses of *euro*57m ($72m) to managers after the company's takeover by Vodafone.

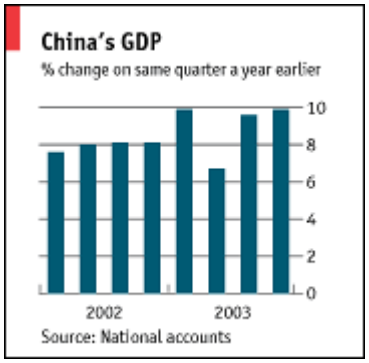
See article: The Mannesmann trial opens

Switzerland mobilises

Switzerland deployed thousands of troops and police around the winter resort of **Davos** to thwart anti-capitalist protesters intent on disrupting the annual meeting of the World Economic Forum. The security arrangements should allow the world leaders, top businessmen and economists present to plot in peace.

China's economic boom continued, at least according to official figures. The country's economy expanded by a blistering 9.9% in the fourth quarter year-on-year and by 9.1% for the whole of 2003, shrugging off the effects of the outbreak of SARS. But the spectacular rate of growth raised fears that the economy could overheat in 2004.

See article: China's property market



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Democratic primaries

A real Iowa surprise

Jan 22nd 2004
From The Economist print edition

The Iowa caucuses brought a mixed result for George Bush, but a good one for America

AFP

A CONSISTENT moan about American politics is that it is all so predictable; whoever raises the most money and gets his face most widely on television is bound to win. Or so it seemed before the first contest of this year's primary season.

Last autumn, Howard Dean, a hitherto obscure former governor, leapt to the top of the list of Democrats seeking to replace George Bush. He shoved aside a trio of senators—Joe Lieberman, John Kerry and John Edwards—as well as Dick Gephardt, the former Democratic leader in the House. Furious with the president about his handling of the Iraq war (and much else besides), Mr Dean seemed to win all the “invisible primaries” that are supposed to make or break candidates. He raised far more cash than all his rivals and got more endorsements, too (from both the Democratic hopefuls in 2000, Al Gore and Bill Bradley, and a cluster of big unions). Interest flickered briefly in another outsider, General Wesley Clark, but at the beginning of the year the fiery doctor seemed well-nigh unstoppable. A Dean v Bush showdown looked much the likeliest entertainment for 2004.

Yet now the voters of Iowa have thrown the whole caboodle up in the air. In their caucuses—an admittedly slightly weird version of democracy (see article)—they gave 38% of their votes to Mr Kerry and 32% to Mr Edwards; Mr Dean finished well back in third place with 18%. Mr Gephardt, who only a week ago had seemed to be Mr Dean's closest challenger in a state which he has won in the past, got only 11%, and promptly left the race.

Next week the circus moves to New Hampshire, where the contestants will be joined by Mr Lieberman and Mr Clark, who both skipped Iowa. But already the political horizon seems to be opening up—towards February 3rd, when seven states hold their contests (including South Carolina and Missouri, which looks wide open now that Mr Gephardt, its favourite son, has dropped out) and even perhaps towards “Super-Dooper Tuesday”, March 2nd, when California, New York and eight other states, offering a third of the total delegates, hold their primaries.

Who has gained from those truculent Iowans? The most obvious winner is Mr Kerry. Nobody suffered more from the rise of Mr Dean than the patrician senator from Massachusetts, who seemed to epitomise the Democratic establishment that had supposedly kowtowed to Mr Bush. Yet as Iowans turned their attention from who best expressed their fury with Mr Bush to who might actually beat him, Mr Kerry's experience began to work in his favour, as did his war record in Vietnam (something unshared by either Mr Dean or Mr Bush). With the race now moving to New England—his home turf, as well as Mr Dean's—Mr Kerry looks a strong contender.

Iowa was also an enormous success for Mr Edwards, the candidate many people in the Bush White House fear most. At his best, Mr Edwards offers a persuasive Clintonian mixture of southern moderation and boyish optimism. But he is a senator of only five years' standing (a much more formidable drawback now that national security dominates people's minds), and seems to have a rather poor organisation in New Hampshire. Mr Edwards's best chance of overhauling Yankees like Mr Kerry will come in the South, though he will face stiff competition there from the Arkansas-based Mr Clark. And that troublemaking reverend, Al Sharpton, the sparkiest performer in the debates thus far, may well take a hefty slice of the potentially large black vote.

Above all, Iowa is less a triumph for Messrs Kerry and Edwards than a setback for Mr Dean. This newspaper has pointed out before that Mr Dean was pushing the Democrats too far to the left—and not just on the issue of Iraq. Clobbering Mr Bush for his fiscal recklessness is to be encouraged; but condemning NAFTA, and refusing to admit that Saddam Hussein's capture may be helpful, seemed neither presidential nor credible. Mr Dean's candidacy still looks extremely strong: he has all that money, he remains an impressive performer on the stump, and he may do better in states with more students and fewer dour farmers. But without some degree of redirection, his campaign risks being dismissed as merely a refuge for malcontents.

The view from the White House

Where does this leave the man whom all Democrats so desperately want to remove? This week Mr Bush gave a somewhat defensive state-of-the-union address, referring often to the Democrats' attacks on his record, and advising America to keep the same leadership to see through the war on terrorism (see article). In the polls, he still outscores any Democrat by wide margins on national security—but his advantage is less clear on kitchen-table issues such as jobs, health care and education. Nevertheless, if the economy continues to recover and the situation in Iraq continues to improve, the president will be a powerful opponent.

Yet from Mr Bush's perspective, the news this week from Iowa was decidedly mixed. On the one hand, the prospect of a long, divisive battle for the Democratic nomination will bring a familiar smirk. The president has his own Republican base firmly behind him, and in the past every incumbent president who has avoided a primary challenge has gone on to win a second term. On the other hand, it is not good news that the Democrats seem to have shifted from loathing him to appraising realistic alternatives to him. Mr Bush would surely prefer to run against the angry Mr Dean rather than against the credible Mr Kerry or the attractive Mr Edwards.

So Iowa is probably bad news for Mr Bush; but it is good news for the United States. This president has done good things, to be sure; but he has also made mistakes in everything from rebuilding Iraq to promoting a pork-laden energy bill to introducing steel tariffs. Such lapses, which will affect people well beyond America's borders, need to be probed far more diligently than they have been. Blind fury is never as persuasive as well-fashioned argument, particularly in such a politically polarised country. In Iowa, the Democrats seem to have come to their senses—and the whole world should gain from it.

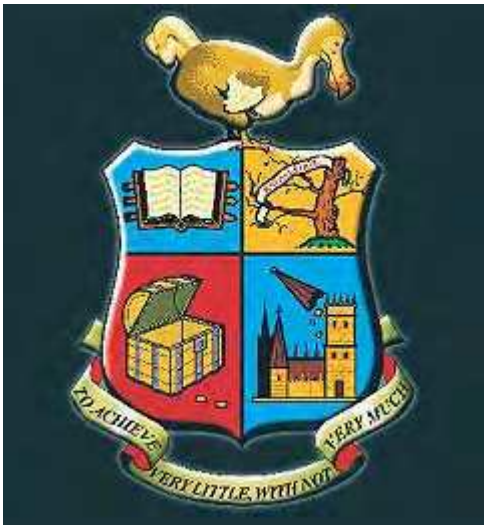
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Universities

Pay or decay

Jan 22nd 2004
From The Economist print edition

If universities are to be truly free and sustainable, most students will have to pay fees



UNIVERSITIES the world over love symbols, from medieval scholastic garb at degree ceremonies to the owls, martlets, chevrons and scrolls of scholastic heraldry. But for many universities, especially in Britain and elsewhere in Europe, a more accurate emblem would include slummy buildings, dog-eared books and demoralised dons. That's why Britain's government is, next week, risking defeat in the House of Commons to bring more private money into the country's universities—and why European and developing countries, now busy expanding higher education, need to think hard about how much government involvement is good for universities.

There are, broadly, two models for running universities. They can be autonomous institutions, mainly dependent on private income, such as fees, donations and investments, or they can be state-financed and (as a result) state-run. America's flourishing universities exemplify the former, Europe's the latter (see article). Britain's government wants to move towards the American model. The subject of next week's rebellion is a bill that would allow English universities (Scotland and Wales are different) to charge up to £3,000 ($5,460) in tuition fees, instead of the current flat-rate £1,125. Students will borrow the money through a state-run loan scheme and pay it back once they are earning enough.

It is a very limited start, laced with sweeteners for students from poor backgrounds. The best universities worry that the maximum fee should be many times higher. But it reflects an important shift in thinking. First, that the new money universities need should come from graduates, rather than the general taxpayer. Second and most crucially, it abandons the egalitarian assumption that all universities are equally deserving.

That is commendable. Just because a course is cheap does not mean it is worthless; the existence of costly ones is not in itself a sign of iniquitous social division. Yet old thinking has deep roots. Bandying phrases such as “excellence for all” and “education for the many not the few”, politicians, especially left-wing ones, want to slap the university-educated label on ever more people, regardless of merit, cost or practicality.

The aspirin theory of university finance

Universities can indeed give the disadvantaged a leg up—but they will do it much better if the state stands back. Micromanaging university admissions, as the British government has been trying to do on grounds of class, with targets, quotas, fines and strictures, risks the same consequences as similar American experiments based on racial preference. It humiliates the talented but disadvantaged, whose success is then devalued; it infuriates the talented who are not deemed underprivileged enough and who feel their merits ignored, and it makes universities do a job they are bound to be bad at.

A good university will need little encouragement to hunt the best talent regardless of class (or race or gender) wherever it can find it. The government may want to subsidise that search, or subsidise loans and bursaries, or provide remedial teaching for borderline candidates. But by far the best route to fairness is not fiddling with the universities, but improving the state school system. When only half the

British school population gains five decent exam passes at 16, and only a quarter gain two decent A-levels at 18, it is hardly surprising that the best universities recruit largely from the best schools—those (public and private) attended by the middle class.

Along with mistaken egalitarian assumptions, governments should also ditch another misconception: the utilitarian notion that universities' main merit is their economic usefulness. Amid much blather about the “knowledge economy”, the core of this belief is that more higher education means higher productivity and more wealth. This lies behind the British government's desire (unmatched by the necessary money) to have 50% of the 18-30 age group in university by 2010 and behind much German anxiety about that country's crowded but increasingly second-rate universities.

Alison Wolf, a British economist, terms this the “two aspirin good, five aspirin better” approach to university finance. It is deeply flawed. In reality, there is no proven connection between spending on universities and prosperity, nor can there be. Those rich countries that spend a lot on higher education may do so for the same reasons they subsidise opera: because they like it, rather than because it makes them richer.

This sounds heretical, but should not be very surprising. Just as people differ, so do their educational needs. An intensive three-year academic course may be just the ticket for one person, but a tedious waste of time for another. Indeed, faced with ageing populations, Britain and most European countries arguably should be encouraging their young people to start earning earlier in their lives rather than later.

Graduated differences

Public funding is addictive, and the withdrawal symptoms are painful. But as British dons and politicians struggle with these issues, and their European counterparts ponder whether, one day, they might just have to do something similar, the message for emerging economies like China and India, who are investing heavily in their own systems of higher education, is clear: avoid a nationalised and uniform system, and go for one that is diverse and independent. America's universities have their problems. Inflated tuition fees are a big worry; alumni preference looks unfair. But overall, America's system looks sustainable in a way that the Old World's does not.

In short, the model to strive for is varied institutions charging varied fees. Not all courses need last three years or bring a full honours degree. Some will be longer and deeper, others shorter and shallower. Some universities may specialise as teaching-only institutions, like America's liberal arts colleges. Others may want to concentrate mainly on research. All must have the right to select their intake.

It is better to do some things well rather than everything indifferently. It is because politicians have forgotten this that some of the world's oldest universities risk a future that is a lot less glorious than their past.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

British courts

The probability of injustice

Jan 22nd 2004
From The Economist print edition

How British courts may have done a great wrong

PA

IT IS hard to think of anything worse that the state can do to people than take their children away from them unjustly. Australian governments did it to the Aborigines in order to try to wipe them out. Communist governments did it to gypsies. But such cruelty is not the preserve of long-gone racists. By announcing the review of 258 trials of parents convicted of murdering their babies and 5,000 cases of children taken into care, the British government is admitting that, for different reasons, the same may have happened in Britain (see article).

Just how much wrong has been done will be known only once these reviews are complete. But what already seems clear is that juries and judges have been giving too much weight to the evidence of "experts" and not enough to the physical evidence—or lack of it—that a crime has been committed.

Dangerous numbers

These reviews have been announced because the murder convictions of two women who had had more than one baby die unexpectedly have been quashed in the past year. Their convictions were based not so much on physical evidence that the babies were victims of anything other than still-mysterious cot deaths, as on the word of Professor Sir Roy Meadow, the prosecution's favourite "expert" witness in such cases.

What became known as Meadow's Law—the idea that one infant death is a tragedy, two are suspicious and three are murder—is based on the notion that if an event is rare, two or more instances of it in the same family are so improbable that they are unlikely to be the result of chance. Sir Roy told the jury in one of these cases that there was a one in 73m chance that two of the defendant's babies could have died naturally. He got this figure by squaring 8,500—the chance of a single cot death in a non-smoking middle-class family—as one would square six to get the chance of throwing a double six. This view took hold in the family court system too. Some of the 5,000 cases to be reviewed involve new-born babies taken away from their parents merely because previous babies had died.

There is an obvious flaw in this reasoning, as the Royal Statistical Society, protective of its derided subject, has pointed out. The probability calculation works fine, so long as it is certain that cot deaths are entirely random and not linked by some unknown factor. But with something as mysterious as cot deaths, it is quite possible that there is a link—something genetic, for instance, which would make a family that had suffered one cot death more, not less, likely to suffer another. And since those women were convicted, scientists have been suggesting there may be just such a link.

How did the juries in these women's cases miss this point? They were, said the improbably-named Lord Justice Judge, handing down his verdict in one of the appeals, heavily influenced by Sir Roy's impressive numbers. He seemed to offer precision in an area of great uncertainty.

This points to the principal lesson from these wrongful convictions. In cases involving areas of scientific uncertainty, such as cot death, the words of "experts" weigh particularly heavily. Yet it is just such subjects, where today's conventional wisdom is tomorrow's discredited theory, that juries should treat "experts" with the greatest scepticism, and should be most unwilling to convict on the basis of their

evidence alone. Perhaps this lesson will help avoid future miscarriages of justice. But it has been learned at a terrible price.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Cloning

Pregnant pause

Jan 22nd 2004
From The Economist print edition

Governments should ban reproductive cloning but allow the therapeutic sort

Alamy

ANOTHER year, another claim to fame through human cloning. On January 17th, Panos Zavos, an American fertility specialist, announced to a press conference in London that he had managed to produce a human embryo through cloning, and then implanted it in a volunteer's womb.

At the moment, however, Dr Zavos seems strangely short of any sort of scientific evidence to back his claim. This is a common failing among those who seek the dubious distinction of being “the world's first human cloner”. Severino Antinori, an Italian fertility doctor, also says he has produced several human clones, again without any proof. And this time last year, the world was agog with claims that the Raelians, a UFO-loving cult, had cloned a baby girl called Eve. Today the infant Eve is as elusive as her biblical namesake.

Clearly, creating a human clone is hard. There are also many reasons why people think such reproductive cloning—creating an embryo by replacing the nucleus of an unfertilised egg with that of an adult cell, rather than allowing sperm and egg to meet—is wrong. Some are put off by the “unnatural” nature of the process. Others fear for the psychological welfare of a cloned child born, say, of a parent trying to recreate a dead relative. But there is also a clear scientific case against reproductive cloning. It remains dangerous for both mother and offspring. Cloned animals still perish in large numbers at all stages of development. If cloning were a drug, and not a procedure, no government in its right mind would allow it near the public given this abysmal safety record in animal testing.

While most countries have regulations on novel medicines, few have laws which deal explicitly with cutting-edge reproductive technology. The United Nations has spent the past three years trying to draft an international convention banning human cloning, but the only thing upon which the UN General Assembly has managed to agree is to discuss the issue again this year. Member states are sharply divided between those, such as America, which want to ban all forms of human cloning and those, such as Britain, which want to allow one particular version of it, called therapeutic cloning.

Therapeutic cloning involves the same laboratory procedure as reproductive cloning. Its aim, though, is not procreation but rather to create a source of so-called “stem cells”, whose unusual properties make them a possible source of replacement tissue for a range of degenerative diseases. Those opposed to therapeutic cloning object to the creation—and destruction—of human life for such utilitarian ends. They argue that therapeutic cloning is unlikely to yield useful medical treatments, and fear the exploitation of women, particularly in poor countries, for their eggs. They also worry that therapeutic cloning opens the door to the reproductive variety.

But others want to give therapeutic cloning a chance. Although many Christians believe human life begins at conception, not all faiths agree and many people have no religious qualms. In any case, strong regulation and strict rules on egg donation can deal with some of these concerns. It is too early to tell if therapeutic cloning will transform medicine. What it offers today, however, is a valuable addition to the scientific toolkit for understanding the process by which an adult cell can regain some of its youthful vigour. If researchers knew enough to reproduce this effect with drugs, then they might be able to skip over embryonic stem-cells altogether, and move straight to stimulating adult cells already in the body.

Making the best the enemy of the good

Disturbingly, opposition to all cloning, led by the United States, has in effect blocked a global agreement on banning the human-reproductive sort, even though nearly everyone agrees that this should be done, at least for now. America should moderate its all-or-nothing stance, help the UN move swiftly to approve a ban on reproductive cloning, and leave therapeutic cloning to the discretion of national governments.

In the meantime, countries should not use delays at the UN as an excuse to avoid passing their own national legislation. America, in particular, needs to put its house in order. Federal legislation on human-reproductive cloning has been held up in Congress for several years, again because of disagreement over whether to outlaw therapeutic cloning as well. Some states have passed their own laws, but such a piecemeal approach is unsatisfactory. America, like other nations, should act against reproductive cloning, and let scientists pursue the therapeutic variety. America's and the world's pregnant pause on cloning has lasted long enough.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Democratising Iraq

Go for the vote

Jan 22nd 2004
From The Economist print edition

Rough and ready elections would be better than rough and ready caucuses

AFP

THE omens for Iraq continue to portend a mixture of hope and horror. But despite the persistence of violence—witness, last weekend, the most murderous suicide bomb in Baghdad to date, leaving at least 25 dead—and the manifold political pitfalls ahead, hope is still, just, in the ascendant.

The immediate question for the Americans is whether to use caucuses or elections to fill the transitional national assembly that is meant to come into being by the end of May. In November they said caucuses were the answer. But now they are under pressure from Iraq's biggest community, the Shia Muslims, to change their minds (see article). At first glance, the Americans have sound reasons to stick to their original plan. It is an oft-made exaggeration to say that the representatives chosen by caucus would be American stooges. Ten of the 15 representatives in each of Iraq's 18 provinces who are to choose the assembly's members would be selected by local and provincial councils, many of which have been directly elected since Saddam Hussein's fall. In some areas it might be difficult to protect the voters, unless many more troops were brought in to deal with the insurgents likely to try to disrupt the polling. Iraq has had no reliable census. Using ration-cards as registration cards would be plainly less than perfect, though they may have been used in local elections. A particular difficulty is that many exiles now back in Iraq have no such cards. Some other means of giving them a vote would have to be found if they were not to be disenfranchised.

Moreover, Grand Ayatollah Ali Sistani, the most powerful voice among the Shias, who is insisting on direct elections with the unstated threat that his disciples may turn violent if his wishes are ignored, has no special right to dictate how the transfer of power should be conducted. By most accounts he is a wise and canny old man who should be listened to with respect. But the Shias are not a monolith. Nor is it clear what sort of democracy—in particular, the degree to which it should be qualified by Islam—the reclusive Mr Sistani wants, though his aides swear he has no wish to see Iraq follow Iran down the barren road to theocracy.

Lastly, the sight of the Americans yielding yet again to pressure from the street and from the largest community's religious leaders, especially when large minorities in the country are increasingly nervous about their ability to affect the outcome, could send the wrong message: that America lacks the authority to stick to its plans and bequeath Iraq a secular democracy in which minority rights are respected.

There is no great issue of principle here. It is a matter of keeping one community happy while seeking not to alienate altogether the others, all the while ensuring that the final objective—a general election at the end of next year leading to an all-Iraqi government under a constitution endorsed by all adult Iraqis—is met. The Americans must simply calculate how fast to go and how many corners to cut in order to keep up the political momentum amid the bombs and bullets.

But the pragmatic reasons for the Americans to bow to Mr Sistani are stronger than those for standing firm. Plainly, the more closely the new assembly reflects Iraqi thinking, the better. Despite the continued instability, reasonably fair elections could be held in many places, especially in the Shia areas where the insurgency has been less disruptive and in Iraq's Kurdish zone, where free votes have been held since Mr Hussein lost sway a decade ago. If need be, selection by caucus could be used in the most dangerous places.

The upshot—a hybrid of election and selection—would not be a model of democratic elegance, but it would be more democratic than the all-caucus alternative. In any event, the government that takes power in July is only scheduled to be provisional. The assembly that writes Iraq's new constitution will be picked by direct election next year, when conditions will be easier, with luck.

But not by luck alone. The United Nations could provide welcome assistance. It will need some reassurance, given the suicide-bomb horror in August that ended its last operation in Iraq, but its experience in election oversight and constitution-writing would be useful. The other missing ingredient is military: instead of reducing its troop strength in Iraq, America should be increasing it. No doubt George Bush worries that that will not help him win his other election, the one back home. But it would be a hollow victory in the United States if it were secured by leaving Iraqi democracy inadequately protected at birth. That, in the end, might be judged a bigger mistake than choosing elections or caucuses, or vice versa.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

North Korea's nuclear taunts

Don't be panicked

Jan 22nd 2004
From The Economist print edition

Unchecked, North Korea will harm anti-proliferation efforts everywhere

Reuters

Get article background

MOST regimes in the illicit mass-destruction business try to hide their diabolical dabblings. Not North Korea. Its answer to American doubts about its nuclear boasts was to invite a private group of Americans earlier this month to view what it said was a lump of plutonium that will soon be turned into weapons unless America meets its demands. So where does that leave George Bush's determination, as he put it again this week, to keep “the world's most dangerous weapons out of the hands of the world's most dangerous regimes”? In North Korea as much as anywhere, the global effort to halt and reverse the spread of weapons of mass destruction, especially nuclear ones, is at a tipping-point. Which way will it tip?

Sometimes the right way. Whatever weapons ambitions Iraq's old regime still harboured ended with Saddam Hussein's overthrow. Pressure there may have given anti-proliferation diplomacy a push elsewhere. America, Britain and the International Atomic Energy Agency (IAEA) have started disposing of the nuclear bits and pieces, as well as chemical and biological weapons and threatening missile programmes, that Libya had secretly acquired before it surprised the world last month by saying it wanted rid of them all. But diplomacy is seldom so easy. Iran, caught last year in a web of nuclear deceit, has grudgingly “suspended” its once hidden uranium-enriching activities (enriched enough, uranium, like plutonium, can form the fissile core of a nuclear bomb) and agreed to more intrusive IAEA inspections. Yet Iran still insists it will hang on to its dangerous technologies. And, as with Iran, failure to get North Korea to kick its nuclear habit could damage anti-proliferation efforts everywhere.

North Korea's recent trigger-fingering nuclear taunts are intended to panic America, China, Russia, South Korea and Japan, all participants in six-way talks to end this nuclear crisis, into a deal that would merely refreeze for now the North's plutonium production (supposedly frozen once before under a 1994 deal), while turning a blind eye to evidence that it has been secretly pursuing a second uranium-enrichment route to a bomb. Troublingly, the tactic may be working with China. China's economic leverage over North Korea is needed to keep up the pressure to disarm. Yet it now notes that North Korea denies trying to enrich uranium, despite an earlier admission to the contrary and other evidence from intercepted machinery shipments. Tiring of difficult diplomacy, China and others may be tempted to think that half a deal is better than none. They would be wrong. Earlier attempts to dismantle North Korea's nuclear programme failed because they left the regime free to continue its threatening behaviour whenever it felt like it, which was often. And without comprehensive checks on all its nuclear activities, it also felt free to cheat on regardless.

Why not just learn to live with a North Korean bomb? There are, it has to be said, few good military options for dealing with the North's defiance. No one knows where it has stashed its bomb-ready plutonium or even where any uranium work may be going on. Any strike would also likely provoke a counter-attack on the South, with many casualties. So why not simply let North Korea know that to use its bomb would be to invite obliteration from America?

The other sort of fallout

Those tempted to leave North Korea's nuclear ambition rampant or only half-checked should consider the widespread collateral damage that would cause. Like its missile technicians, North Korea's nuclear experts could fan out, peddling their wares to anyone with the cash to buy (indeed, some may have done so). And its nuclear posturing has already stirred debate in Japan about its nuclear future. South Korea and Taiwan have both toyed with building bombs in the past. All three could turn nuclear at speed. Such nuclear turbulence would harm security all round, China's included.

The only safe way to deal with North Korea's claimed nuclear weapons is to get rid of its capacity to make them, “completely, verifiably and irreversibly”, as America has insisted. If North Korea refuses, it should face isolation from all. Other options, including military ones, may start to look less outlandish if diplomacy is seen to have failed.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Letters

Jan 22nd 2004
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

AIDS: a little better

SIR – Your report on the recent HIV household survey in Kenya suggests that apparent discrepancies between preliminary results and the UNAIDS/WHO estimates of the HIV epidemic in Kenya mean that prevalence rates should possibly be adjusted downwards elsewhere in Africa ("Good news, apparently", January 17th). In fact, UNAIDS/WHO has incorporated information from several recent national household surveys in Africa, resulting in an estimate for sub-Saharan Africa of 26.6m people living with HIV/AIDS, 10% lower than previous estimates.

There has been no conspiracy to inflate numbers. On the contrary, there have been steady improvements in the modelling methodology used by UNAIDS/WHO and partners, along with better data from country surveillance. These have led to lower global HIV/AIDS estimates, not just for the current year but also for past years, despite the continued expansion of the global epidemic. The upward trend is unrelenting.

Currently, UNAIDS/WHO is working to update country estimates, which are critical for monitoring the progress of the epidemic and responses to it. However, when they are adjusted as a result of new data and refined modelling tools, this does not necessarily indicate that the epidemic is receding. As you correctly conclude, the AIDS epidemic in Africa remains awful.

Dr Catherine Hankins
Chief scientific adviser
UNAIDS
Geneva

A lengthy war

SIR – If Europeans believe that Americans do not realise that the "war on terror" will continue throughout our lifetimes and has no definitive end they are sorely mistaken ("Still out there", January 10th). George Bush and other officials regularly speak to those facts, but you make it sound as if we are clueless about the reality of the situation on this side of the Atlantic. We use the term "war" because it signifies the seriousness of the struggle and the greater investment of resources, not because we think that a few battles from now we can all sleep peacefully again.

J.D. Bolick
Denver, North Carolina

Unwanted legacy?

SIR – You miss one crucial distinction in your effort to expose the supposed hypocrisy of the system of "legacy preferences" at America's top universities (Lexington, January 10th). It is reasonable to argue that a "private" university—such as Yale, Harvard or Notre Dame—has every right to give its best clients preferential treatment. Smart businesses always endeavour to strengthen the loyalty of their most lucrative customers. After all, frequent fliers or high-net-worth investors get special attention.

When "public" universities (such as the University of Virginia), which obtain financing direct from the taxpayer, start doling out goodies to favoured patrons, that looks like graft and corruption. If public universities want to grant preferences (racial, legacy or otherwise) they should give taxpayers their

money back.

Britton Manasco
Austin, Texas

SIR – America's legacy system is entirely inconsistent with the country's meritocratic ideals. Progress on this issue will not come from politicians. Instead, it must come from donors, who should be made to see the virtue of holding their alma maters, their children and themselves to higher academic and moral standards. If these donors wish to help their children, they should begin by teaching them the value of hard work and merit, not how to buy one's way out of an underachieving high-school career.

Noah Stein
New York

SIR – Lexington avers that America's top universities "control access to the country's most impressive jobs". Really? Maybe a degree from such a college helps to provide an entrée to such jobs; or maybe graduates of the top universities hold elite jobs because the most capable people tend to gain admission to such schools. But to say the top colleges control access to top jobs is over the top.

Jonathan Dubitzk
Brookline, Massachusetts

SIR – A friend of mine (Harvard 1962) remarked about the need for legatees at Ivy League universities: "They need a bottom half of the class."

Albert Kirsch
Bal Harbour, Florida

Colombia's crackdown

SIR – While it is true that there are fewer homicides, kidnappings and internal displacements in Colombia, President Álvaro Uribe's security plan also includes a stunning rise in the number of civilian arrests ("You do the maths", January 10th). Most are charged with terrorism; some are defenders of human rights. Using Colombia's broken judicial system to try civilians who are deemed terrorists is extremely dangerous.

Judges, lawyers and witnesses are regularly manipulated by armed groups through threats and violence and many of Colombia's institutions have ties to armed groups and drug traffickers, most notoriously the well-documented collaboration between the military and right-wing paramilitaries. Unfortunately, Mr Uribe's plan does not include protection for the thorns in his side: human-rights defenders.

Liza Smith
New Orleans

SIR – Mr Uribe may call his plan to wipe out rebels "mathematics" but anyone who has studied Xeno's paradox knows that multiplicative decay is an asymptotic function: it never reaches zero. Experience suggests that the last pockets of resistance are by far the hardest to exterminate. The only way to eradicate such powers is to eliminate their incentive to exist by decriminalising the drug trade.

Aaron Brick
San Francisco

Is that a gun in your pocket?

SIR – Contrary to your claims of the Americanisation of armed robbery in Britain, one could only hope that robbery in England and Wales was truly becoming Americanised ("You're history", January 3rd). The International Crime Victimisation Survey shows that for 2000, the latest year available, the robbery rate in England and Wales was twice America's rate.

Equally tellingly, your figure shows that armed robberies stopped falling in England and Wales in 1997 and started rising dramatically almost immediately afterwards. Was not the 1997 handgun ban in Britain supposed to reduce armed robberies? By contrast, American robbery rates have fallen during the 1990s

just as more and more Americans have been able to carry concealed handguns for protection.

John Lott
American Enterprise Institute
Washington, DC

Running together

SIR – You gave both candidates in the 1988 American presidential election—George Bush senior and Michael Dukakis—the collective name “Mr Bushakis”. Your cover of January 3rd inspires me to suggest a name for the younger George Bush and Howard Dean, the potential candidates in the forthcoming election: Mr Bean.

Henrik Arve
Stockholm

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com SPECIAL
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Financing universities

Who pays to study?

Jan 22nd 2004
From The Economist print edition

When universities depend on taxpayers, their independence and standards suffer

IT IS depressing to visit Oxford or Cambridge these days. The old buildings are so wonderfully grand that they highlight the cheap, ugly and badly kept new ones. The intellectual history is stunning, too: this is where Newton pondered gravity, and Occam honed his razor. But these days academics at Britain's two finest universities are a harried, ill-paid lot; salaries start at a mere £14,139 ($25,733).

Few disagree that both universities are living off the past, in everything from cash to reputation. The colleges' wine cellars are better than the kitchens, quips one don. The port and claret were laid down in happier times, when cash was flush and planning for the future mattered. But the food that goes with them is often dismal: that must be bought out of current income, which is usually earmarked already for everything from maintaining ancient buildings to supplementing salaries.

Yet Oxford and Cambridge are still in relatively good shape, thanks largely to their structure of self-governing, self-financing colleges. This limits the power of bureaucrats, provides independently managed money and ensures some protection for the original and the excellent. Other British universities have much worse problems.

To begin with, they have little or no endowment income to fall back on. The combined investments of Oxford and Cambridge are £4 billion; the rest of the British university system has £1.7 billion to play with. In America, Harvard alone has twice Britain's total. The “funding gap”—the hole in the universities' collective accounts created by the unfunded expansion of the past 20 years—is around £10 billion.

It is not just that money is short. The price and quantity of courses are state-controlled, in a system more suited to Soviet central planning than to a modern democracy. And as with other planned economies, the result of government intervention is increasingly unsatisfactory. In Britain, over 30 years, universities have gone from being almost wholly autonomous, with state-financed block grants handed out at arm's length, to becoming branch offices of a government ministry.

Admissions, too, bring a whiff of the old Soviet system. The government is convinced that more working-class students, including many with few formal qualifications, should go to university. Its ultimate target is 50% of 18-30-year-olds by 2010, and it is getting there fast. Figures released this week show that the number of students in higher education has risen in just one year from 43% to nearly 45% of the relevant age cohort. In 1979, the percentage of school-leavers going on to higher education was just 12.4%.

But more does not always mean better. One of Britain's best-known academic institutions, the School of Oriental and African Studies in London, found itself penalised for taking too few students from “non-

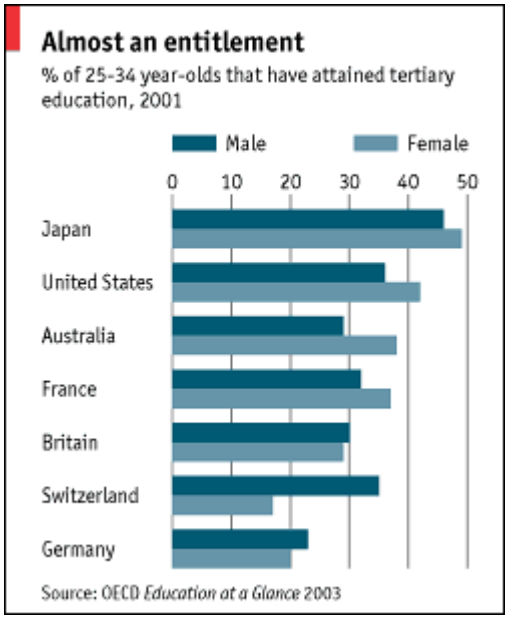
traditional" (meaning poor) backgrounds. So it reduced entry requirements for such applicants, to take account of their often modest school results. But then it turned out that those students found learning Arabic or Chinese from scratch so hard that they were dropping out, incurring a further fine from the government.

The story of British higher education is less about expansion than inflation of qualifications. University degrees mean less and less and there are more and more of them. The rot set in in 1992, when the Conservative government allowed the polytechnics—locally based institutions that originally specialised in vocational teaching—to relabel themselves universities. That created a panoply of new academic courses, many of dubious merit, and kicked away a vital pillar of the higher education system, between the purely vocational further education colleges and the fully academic universities. This trend towards uniformity has disastrously weakened higher education in Britain.

Hence the importance of the government's proposed reform of university finance, which will allow a modest liberalisation of tuition fees. Instead of the current flat rate of £1,125, universities will be allowed to charge up to £3,000. The scheme is festooned with carrots, chiefly easy terms for poor students, in order to forestall a revolt by the government's nominal supporters in Parliament.

Critics say the new fees will create an unmanageable debt burden. Yet a broadly similar system in Australia has not had this effect: graduates pay back the loans when they are earning enough.

The scheme's real weakness, as most of the best universities admit in private, is that the top fee should be a lot higher; the cost of actually teaching an undergraduate is at least £10,000 in the humanities, more in engineering and science. But the most welcome ingredient is variability: universities will at last have the chance to offer cheaper, shorter courses to students willing to pay. The misguided notion that all courses at all universities are equally good seems about to be punctured.



Woes across the Channel

The present picture in Britain may be dismal, but misery is relative. Strolling happily through the Oxbridge quadrangles, and in the bustling corridors of less beautiful British universities, are 12,000 undergraduates from other European Union (EU) countries. Their home universities are in a still worse state: not only more overcrowded, but with barely a vestige of direct teaching. Oxford and Cambridge, more than other British universities, still offer undergraduate students close attention from a designated don.

The system is threadbare and arguably wasteful, especially as many students do little to prepare for their supervisions. But at least it happens. At France's best-known university, the Sorbonne, a translation seminar at the start of last term had 80 registered students. "Too many," said the teacher superciliously. "Half of you have to leave. When we are down to 40 I'll start teaching. Foreigners will go first."

In Germany, too, where professors enjoy the status of tenured civil servants, conditions are frequently dreadful. A current scandal is the *Blockseminar*—an ingenious system whereby an academic turns up briefly at the university and delivers an entire term's teaching in the space of a weekend, before returning to the unhurried pursuit of private knowledge.

Similar stories come from Spain and Italy, where universities are plagued by rigidity and corruption. Last year, students at Rome's Sapienza University were found to have paid up to €3,000 ($3,400) to pass their exams; and a professor at the University of Bari was arrested for demanding sexual favours in exchange for getting candidates onto the psychology course.

In effect, universities in these countries have become government-owned degree mills. Their aim is to get the greatest number of young people in and out for the least money and trouble. Really determined students may fight their way through to gain a professor's attention, win a research scholarship and start doing some real work, probably in postgraduate study. The others will arrive in the labour market, qualification in hand, feeling that their mostly middle-class parents have something to show for their taxes.

It is not all gloom and doom. Most countries have islands of excellence: German postgraduate engineering faculties, for example, or the French *grandes écoles*, fiercely competitive and independent. Finland and Holland have largely managed to keep quality up and bureaucracy down. But for the most part, universities in the larger countries of continental Europe are a dreadful warning of the consequences of nationalisation.

No wonder, then, that British and European academics cast envious and wondering eyes at the American university system. It manages both quantity and quality: more than 60% of American high school graduates at least start some form of tertiary education. And it keeps standards high, too. The European Commission recently published a painstaking ranking of the world's best universities, compiled by researchers in Shanghai. Of the top 50, all but 15 were American. From Europe, only Oxford and Cambridge made it into the top 10; from other EU countries, no university ranks higher than 40.

The American system is not flawless. The diversity which makes the system so dynamic also leaves it vulnerable to abuse. In the humanities, intellectual fashion seems bizarrely distant from the real world. Many bad ideas—notably political correctness—started life as American campus fads. And budget pressures squeeze the system when times are tough. This year, the axe has fallen hard on California's public universities.

Yet for all that, the numbers going into American higher education continue to rise, and the average tuition fee in an American university is around $4,500—some $1,000 less than the proposed maximum to be charged in England. Fees in the California state system, even after two steep recent rises compelled by leaner budgets, are less than $3,000, and a third of the income from them goes into grants for students who cannot afford even that.

Degrees of difference

Why does America succeed where Europe fails? The most important factor is diversity. American higher education is not just more varied, but has less of the crippling snobbery and resentment that accompanies variety in, say, Britain. At the bottom of the pyramid are community colleges, offering inexpensive, flexible, job-focused courses for millions of Americans each year. They are pretty basic, and Britons sniff at them. But the difference in mentality, says Martin Trow, an observer of both the British and American education systems, is that in America “something is seen as better than nothing”.

Crucially, too, the different bits of the system fit together. As Mr Trow points out, a student can start in a California community college, earn some credits, move on to state university and finish up taking a degree at Berkeley. Such a path would be inconceivable in most countries in Europe. In France, for example, the division between the state-funded, mass-market universities and the *grandes écoles* is vast and jealously guarded. Britain's further-education colleges are the poorest relations of an already impoverished family.

American universities are also fiercely competitive: for talented staff and students, for donations, for results (though competition on fees at the top end, where tuition can cost tens of thousands of dollars a year, is yet to come). Fund-raising efforts at the best-organised universities start even before students have graduated. Star professors attract star salaries.

That contrasts with the two extremes across the Atlantic. In Britain, performance is so minutely measured by the state that it stultifies the efforts of the brilliant, without really rooting out the incompetent and lazy. State supervision, coupled with penury, gives universities the smell of a failing nationalised industry, rather than of world-class outfits devoted to the risky business of thinking original thoughts.

In much of continental Europe, the problem is that senior university staff are not scrutinised enough. The intention, to keep academic freedom sacrosanct, is admirable, but the cocoon has become a prison. German academics are all but forbidden by law from getting involved in business. The best motivators for academic excellence are money, recognition and team spirit. But the German system penalises success in the name of equality: a university that does too well in the eyes of the federal

bureaucracy will have its funding cut. So great is the risk of entrenched mediocrity that the chancellor, Gerhard Schröder, has urged the creation of—horrors—ten new elite universities.

A crucial part of competition is flexibility in setting fee income. Most European countries charge little or nothing. But fees have two beneficial effects. The first is that the university is beholden to nobody in its planning. Engineering and medicine are expensive to teach, so they cost more. Law is in high demand, so it is rationed by price at places like Harvard. But these are the university's own decisions. If it wants to teach something expensive, it can raise the money from fees, or from outside donors, or subsidise it from its endowment. It is not left, as Britain's academic managers are, wondering if it can squeeze money from the English department to keep the chemistry labs open.

Fees also mean that students are much more motivated. Underpriced goods and services are usually wasted, and university education is no exception. In a new book*, Robert Stevens, an academic who has run colleges in both America and Britain, writes of “an alcoholic yobbish culture” among students, for whom university is principally “a rite of passage”, like national service in the army, rather than an education. When Austria introduced a modest tuition fee of €363 per term in 2001, the number of students enrolled dropped by a fifth. Many, it seemed, were signing up simply for benefits such as health insurance.

But fees will also make students more powerful customers. Teaching at American universities is much better presented than in most European ones. Visiting American students are often startled to attend lectures with no visual aids, out-of-date hand-outs and droning, inaudible speakers. Such complacency will not long survive when customers have a choice.

The last big issue is selection. In most of continental Europe, this is a taboo. Access is either entirely open to anyone who has passed the school-leaving exam, or, at most, is rationed according to the marks gained. Universities, in effect, have to take the students the government sends them.

That sounds good, but works badly. The advantage of university-based admissions is that academics end up choosing the people they really want to teach. Students are more likely to focus on the course they want to study, and to try to meet the university's specific requirements.

Dream on, spires

American universities, with their mighty reserves of talent and money, look well placed to compete with the world's new academic powerhouses in India and China (which last year alone produced 2m graduates). How can sleepy Europe and timid Britain even hope to keep up?

The best hopes are in the piecemeal changes that are already happening. Students, for example, are voting with their feet. Britain's Open University, which offers part-time courses by post and e-mail, says that young people of university age are its fastest-growing bunch of students, up nearly 5% this year. That suggests that the disadvantages of a dumbed-down full-time undergraduate course, with the attendant debts and time spent not earning, are beginning to bite.

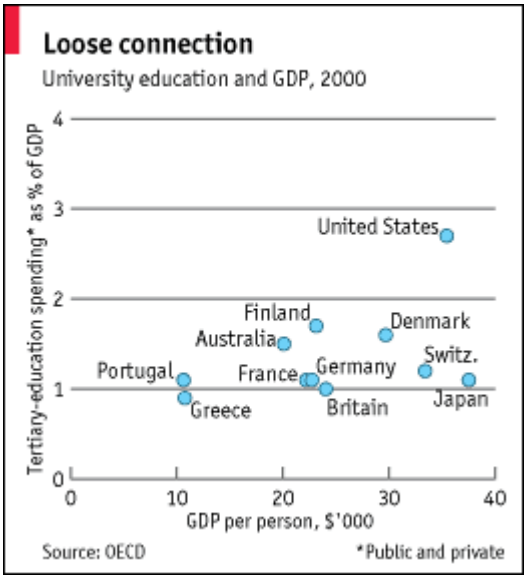
Employers too are signalling that there are too many graduates with indifferent qualifications. With luck, the British government's ill-starred 50% target may turn from its original force-feeding of the universities to a harmless exhortation that people should do something educational at some point after they leave school.

The days of social engineering may also be drawing to a close. The British government's proposed “access regulator”, an official body originally designed to force the top universities to take fewer students from fee-paying schools and more from poor backgrounds, seems unlikely now to penalise anyone. Just as well. Harvard and Stanford are both shopping for talent at

Britain's top private schools, where pupils have been deterred from studying in Britain by official contempt for their class.

New institutions have sprung up, too. In Germany, the city-state of Bremen has set up an independent private university in conjunction with Rice University of Texas. “We wanted to be able to select students, to charge tuition fees, to have excellent and competent professors, to teach in small groups and in decent working conditions,” says Fritz Schaumann, its director.

Five years after its foundation, the International University of Bremen has 500 students, who contribute just over €3.5m in fees. It raises a further €20m a year from endowment income and donations. Other German universities at first regarded the newcomer with great suspicion. Now they are co-operating, for example in joint research programmes. Eventually, says Mr Schaumann, they will have to adopt a similar model.



Old institutions are also behaving in new ways. Britain's London School of Economics (LSE), for example, has largely escaped from the state's clutches. It now gains most of its income by selling courses to students from outside the EU, whom it can charge market fees. With that money, it can afford to hire world-class staff. “This is the only way we can compete with American academic salaries,” says Sir Howard Davies, the LSE's director.

For Britain's best universities, the big question now is whether to wait for more denationalisation, or to move towards freedom on their own initiative. For Europe's universities, the question is whether they can stop talking about reform and actually introduce some. Meanwhile, America's universities, hugely wealthier, happier and brainier, march remorselessly on.

---

*“University to Uni: The politics of higher education in England since 1944”. Robert Stevens, Politico's, £15.99

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Iowa caucuses

Who loves a winner?

Jan 22nd 2004 | DES MOINES
From The Economist print edition

EPA

A coup for John Kerry; Howard Dean humiliated. Iowa has blown open the race for the Democratic presidential nominee and guaranteed that it will last longer

NINE minutes before the start of caucus meetings across Iowa on January 19th, a dazed tramp crashed through the doors of Howard Dean's campaign headquarters in Des Moines: it looked, perhaps, a warm and intriguing place, and even a drink might be had. Three minutes later the tramp was being bundled out of the building by two new friends, Dean volunteers from Missouri, who rushed him by car to the precinct caucus nearest his shelter. “I will vote for your man!”, he emphatically repeated, relishing his importance.

Little good it did. Opinion polls had for months suggested that Mr Dean's insurgency—built on opposition to George Bush, to war in Iraq, and even to the Democratic establishment—had made him the clear favourite for the Democratic presidential nomination. Iowa seemed a shoo-in. After all, his army of orange-hatted enthusiasts was crawling over the state.

Instead, Mr Dean crashed in Iowa, coming third with a mere 18% of the votes, less than half of what he expected. The other candidate said to have “organisation”, Dick Gephardt, fared even worse, with 11%—and bowed out the next day (see article). Instead, Senator John Kerry of Massachusetts romped home to a famous victory, with 38% of the vote, followed by Senator John Edwards of North Carolina, with 32%. In the informal futures market in presidential shares arranged by the University of Iowa, Mr Kerry has now swept past Mr Dean (see chart).

Cynics argue that the sort of political junkies who trade political futures are prone to lay too much importance on the Iowa caucuses. Not only do they send a piddling number of delegates to the Democratic convention, they are also usually poor predictors of future success. By contrast, the winner or runner-up in the New Hampshire primary, due on January 27th, has gone on to get the party's nomination in 11 of the past 13 elections.

However, even with this caveat, these particular Iowa caucuses seem important. At the very least, they

have dramatically opened up a race that everyone had assumed was narrowing, pushing Messrs Dean, Kerry and Edwards into a fierce contest with Wesley Clark and a somewhat fading Joe Lieberman, who both stayed out of Iowa. The caucuses may also have prolonged the contest well into the spring.

The main beneficiary is Mr Kerry. Only a few weeks ago his presidential bid looked hopeless. Caught off-guard by Mr Dean's insurgency, he came across as wooden and patrician—just what you would expect of a New England senator, but not what Democratic voters fuming at Mr Bush were in the mood for. Ominously, money was failing to come in.

Then, late last year, Mr Kerry fired his campaign manager, borrowed $6m against his house and rebranded his message, appearing to show a great deal more concern towards what ordinary people said they wanted. In his stump speech, he challenged Mr Bush to come forward and engage him on the big issues of the day: foreign policy, security and the economy. Iowans, at least, decided that he was an electable proposition.

Mr Edwards seems to have appealed to much the same sort of voters as Mr Kerry—the only difference (an ironic one, given the way Mr Edwards stresses his poor upbringing) being that his supporters seemed more well-heeled than Mr Kerry's. His repeated theme is inclusion: he does not want to represent one half of the 50:50 nation but all of it. His internet site has far more policy details than anybody else's does. And to complete the Clintonian comparison, the boyish southerner also seems to be doing well with the fairer sex.

More poignantly, the caucuses have revealed deep flaws with the Dean campaign. Take, first, Mr Dean's opposition to the war in Iraq. What if the war is no longer even a defining issue of the campaign? For months, Mr Dean has attacked Mr Kerry, among others, for voting with Mr Bush in favour of war. Yet in Iowa Mr Kerry appears to have won more support than Mr Dean from those who opposed the war.

Both Mr Kerry and Mr Edwards have laid emphasis upon economic issues, such as jobs, health care and trade. This points to another flaw in the Dean campaign. When it comes to the economy, he may have pushed too far to the left. His rhetoric is often protectionist or anti-business. The chief plank of his economic policy is repealing all Mr Bush's tax cuts; Mr Kerry, by contrast, says he will keep most of them, claiming the middle class should not pay for Mr Bush's mistakes.

Perhaps the deepest flaw, however, has become the issue of “character”. Until this past week, it has been possible for supporters of Mr Dean to represent his gaffes as “truths” that the “Washington establishment” did not like to hear. It is now much harder to do this. A few days before the Iowa polls, Mr Dean snarled at an elderly Bush supporter, telling him to shut up and sit down: even his campaign team winced. Then, after news of the poor caucus showing came in, Mr Dean attempted to rally supporters by delivering a red-faced, gesticulating rant, ending in a banshee-like scream. The speech can, most charitably, be interpreted as a miscalibration. To many, it looked plain scary.

If the spotlight of the past month has not flattered Mr Dean, how will Mr Kerry fare? Assuming electability is the new touchstone among Democratic voters, then a calm, experienced Washington insider certainly looks more appealing than an angry outsider. Mr Kerry has been moving back up the New Hampshire polls, towards the levels he enjoyed before Mr Dean burst upon the scene.

Mr Kerry these days artfully ticks off qualities that opponents lack (though he rarely mentions his rivals by name). Against Mr Dean, he can prove a tried and trusted ability to keep his cool. Against Mr Clark, he lays emphasis on his experience in moving things through Congress (and the fact that he has a record of voting for Democrats). Against Mr Edwards, he has maturity—three decades of political life against Mr Edwards's single Senate term.

But it is against Mr Bush that Mr Kerry presents his reinvigorated credentials with the greatest emphasis. He reminds listeners, to cheers, that he knows “something about aircraft carriers for real”. He also cites his long experience in foreign-policy and security issues. Stand with me, Mr Kerry urges voters, “and together we will rejoin the commonwealth of nations”. At home, he mixes populism (special interests are blamed for a lot in his speeches) with the sort of vague, optimistic phrases that Bill Clinton loved: for instance, rather than having “Americans work for the economy”, Mr Kerry wants an “economy that works for Americans”.

This all sounds wonderful, but Mr Kerry's problem in tackling Mr Bush may be exactly the same thing that won over the voters of Iowa: all those years of experience. Republicans think that the senator's voting record in Congress gives them more than enough material to nail Mr Kerry as another north-eastern

liberal.

As Democrats realise that, might the spotlight move on to Mr Edwards? New Hampshire will not be an easy state for him. In the polls there, his support sits in single digits. Some analysts think that his success in Iowa sprang from the kind of last-minute horse-trading for which the caucuses are well known: in entrance polls, he showed much lower support. For now, the youthful Mr Edwards is certainly the thinking woman's crumpet; but he is still relatively unproven.

With so many doubts, the spotlight might well move on again. To Mr Clark, perhaps? Back to Mr Kerry? How about a reformulated Mr Dean? The suspicion remains that the Democratic Party has not made up its mind what it wants. The worthies who constructed the primary timetable hoped to get a quick result. They then got extremely nervous when that quick result looked as if it was going to be Mr Dean. Now there is every prospect of the race lasting well into March.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Farewell, Dick Gephardt

The nearly man

Jan 22nd 2004 | ST LOUIS
From The Economist print edition

Not on our side—but an honest fighter nonetheless

EPA

The man from Missouri

DICK GEPHARDT'S political career came to a full if imperfect circle. In a room in the St Louis convention centre, not far from the city hall where he entered political life as an alderman three decades ago, and close to Union Station, where he launched his first run for president in a noisy celebration in 1987, he gathered with his family for one last campaign appearance.

Only 24 hours earlier Mr Gephardt had seemed supremely confident, predicting with all sincerity that he would win the Iowa caucuses, as he did in 1988. Instead, he finished fourth, with a mere 11% of the support. In his hometown, Mr Gephardt announced he would serve out his 14th term in Congress and pass into private life.

With his family lined up behind him on the stage, this was rather like a funeral in which a life's dream, rather than a man, was laid out as a corpse. Mr Gephardt had a chance to be president in 1988, but fell short. He might have won in 1992; but he was afraid to take on the incumbent, George Bush senior, leaving the race to the less well known governor of Arkansas. After he became leader of the House Democrats he ached to become speaker, but failed in four attempts. Last year he gambled everything on one last bid to be president, stepping down from his leadership post and abandoning his safe seat in Congress.

His shockingly bad finish was a surprise, but there had been ominous signs. Despite three decades of devotion to organised labour, he was stabbed in the back by the biggestunions, which endorsed Mr Dean. Mr Gephardt still picked up various manufacturing unions, but these—no less than his endorsement by both Barry Manilow and Michael Bolton—only seemed to make his candidacy more dated.

For much of his career, Mr Gephardt was America's foremost protectionist. This position was not formed by some think-tank or focus group. In the blue-collar district he has represented since the 1970s closed factories are not statistics, but part of the landscape. People curse the loss of jobs overseas and blame trade policy for the fact their children's prospects seem to be more limited than their own. Mr Gephardt embodied that strain in American life.

Although he was never hip, Mr Gephardt leaves public life without a blemish of scandal. Even his worst enemy would concede that he was an honest public servant. After an emotional tribute to his family, the normally reserved congressman said he was not ready to endorse anyone else, although he had heard from all of them. “You form a bond with people even when you run against them,” he said.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The state of the union

In search of a theme

Jan 22nd 2004 | WASHINGTON, DC
From The Economist print edition

The state-of-the-union address was dull but revealing

Get article background

IT WAS a *coup de théâtre* that fell flat. The president's state-of-the-union address came a week earlier than usual, one day after the Iowa caucuses, one week before the New Hampshire primary.

AP

Don't worry: I was asleep too

Compare the two sides, the occasion seemed to say. On the one hand, a bunch of squabbling Democrats; on the other, the commander-in-chief addressing Congress and the country. But instead of providing a nation-stirring response to terrorism (as in the 2002 address) or a preparation for war in Iraq (the 2003 speech), the president this time seemed to be testing out his stump speech. It could have been given to the Republican convention later this year, sniffed one of Howard Dean's policy advisers.

Conventional wisdom says incumbents should look forward to what they would do in a second term, not back to what they have done. Comprehensive health care on Mars was one wag's suggestion of what this year's grand promise might be.

In the event, Mr Bush eschewed the vision thing and gave a speech that was almost Clintonian in its small-bore obsessions. He offered $23m to expand drug testing in schools, $270m for teenage-abstinence programmes and $250m more for community colleges. He even urged sports coaches to crack down on athletes' use of steroids. Before the speech, General Wesley Clark's campaign had prepared a detailed rebuttal that compared the general's vision of America with the president's. The general had to scrap half his speech. There was no vision to rebut.

Instead, the president offered a summary of past achievements: the conduct of the war against terrorism (no new attacks in America since September 2001); progress towards more stable, more liberal governments in Afghanistan and Iraq. He claimed credit for the economic rebound. He praised the effects of his two most important social policies, education reform and Medicare reform. Except for an appeal to make the tax cuts permanent, and a minor tweak aimed at cutting health-care costs, it was literally an argument for staying the course.

Confirming its campaigning nature, the speech spent some time reacting to Democratic criticism. “Some

critics," Mr Bush said [you know who they are: the ones in New Hampshire] "have said our duties in Iraq must be internationalised. This particular criticism is hard to explain to our partners." He then reeled off a list of 34 countries with troops in Iraq. "I know that some people question if America is really in a war at all," he continued, but "the terrorists are still training and plotting." Anyone who claimed his education reform was a failure (as Democrats do) was obviously against accountability and higher standards.

Mr Bush's advisers have said repeatedly that they expect a close election. That prospect may explain his defensiveness (he does not want to take any risks). It may also explain several examples of interest-group politics in the speech.

Mr Bush repeated a proposal, floated two weeks ago, to set up a new regime for illegal immigrants—an attempt to appeal to Hispanic voters. He borrowed an idea discussed by the Clinton White House for a "prisoner re-entry initiative" (helping prisoners find work and a home upon release). This seems to be aimed at blacks, who represent a disproportionate number of prisoners in American jails.

He endeavoured to cement his appeal to evangelical Christians with a ringing cry that "our nation must defend the sanctity of marriage". But in an attempt not to enrage secular voters, he stopped short of endorsing a proposed constitutional amendment to ban gay marriage. In all this Mr Bush is abiding by the new rules of the 2004 election: fire up loyalist groups on your own side, while seeking to keep your opponents' shock troops in check.

If the state of the union is any guide, all this means that Mr Bush is planning to run on his record. With the economy rebounding, broad public support for the war on terror and big reforms in education and health under his belt, that may be understandable. But there is a risk. It is all very well claiming credit for, say, progress in Iraq, but this says nothing about the problems of transferring sovereignty in that country. It is fine to boast about the recovery, but this fails to address the problems of the soaring budget deficit in the short term. By refusing to offer some new theme for a second term, Mr Bush will find it harder to reply to such criticisms.

But perhaps there will be a theme. Arguably, there has to be. If Mr Bush were to win, his second term would end on the verge of the baby boomers' retirement. It would be a last, last chance to solve the great problem of American domestic politics: reform of the entitlement programmes of Social Security and health care. That may be the unspoken subject of the 2004 campaign.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The electoral week

Primary colour

Jan 22nd 2004
From The Economist print edition

Message of the week
"Dated Dean. Married Kerry" *Kerry supporter's badge, Iowa*

Hot fashion tip
"I don't believe it's patriotic to dress up in a flight suit and prance around on the deck of an aircraft carrier." *General Wesley Clark, January 8th*

Garment of the week
Mr Clark's argyle sweater, cruelly mocked by some members of the media, has been put up for sale on eBay. After just five days, its price had risen to more than $5,000.

Elegy for a campaign (1)
"Wear comfortable shoes." *Carol Moseley Braun's advice to future female presidential candidates after she ended her campaign,* New York Times*, January 16th*

God help America
Celebrity supporters of presidential candidates

John Kerry: Quincy Jones, Carole King, Bette Midler, Jerry Seinfeld, James Taylor, Kathleen Turner

Howard Dean: Michael Douglas, Melissa Etheridge, Joan Jett, Paul Newman, Rob Reiner, Susan Sarandon, Martin Sheen, Robin Williams

Wesley Clark: Alan Alda, Madonna, John Mellencamp, Michael Moore

John Edwards: Larry David, Hootie and the Blowfish

Joe Lieberman: Jerry Stiller

Al Sharpton: P. Diddy

George Bush: Chuck Norris

Conservative gloat of the week
"Due to bandwidth restraints, the 'Dean goes nuts remix' is no longer available for download." Right Magazine *website, January 21st*

But they all look alike
"Four-fifths of registered voters who want to take part in Democratic primaries or caucuses say they don't know enough about the presidential candidates to make an informed choice. Half of those who had picked a candidate said there was a good chance they could change their minds." *National Annenberg Election Survey, Associated Press, January 18th*

Elegy for a campaign (2)
"I don't do this 18 hours a day, seven days a week, to be president. I don't need to be president. I don't care about that." *Congressman Dick Gephardt on January 18th, one day before Iowa's caucus-goers decided to set the former Democratic House leader free*

Understate of the union
"The man who told Congress a year ago he was headed to war arrived this year with…an appeal to athletes to stop popping steroids." *David Von Drehle describing George Bush's state-of-the-union speech,* Washington Post*, January 21st*

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Voting machines

Good intentions, bad technology

Jan 22nd 2004
From The Economist print edition

High-tech voting machines are making things worse, not better

ANOTHER election year, another recount fiasco in Florida. On January 6th, a local election was held for a seat covering parts of Broward and Palm Beach Counties. A total of 10,844 votes were cast, and Ellyn Bogdanoff won by a margin of just 12 votes. There were also 137 undervotes, in which voters' choices failed to register. Under state law, there must be a manual recount of all undervotes and overvotes (ballots marked more than once) in any election where the winning margin is less than 0.25%. But no recount is possible, because the votes were cast using touch-screen voting machines whose only paper output is the final tally.

The machines can be asked to print out the same result again, of course. But as Robert Wexler, a Democratic congressman, likes to point out, “a reprint is not a recount”. He has just filed a suit arguing that the machines violate state law, and asking a judge to order that they be equipped with printers, so that voters can verify their decisions on paper. The paper copies would then be placed in a ballot box, for recounting if necessary.

AP

Spot the missing chad

This case has highlighted a growing debate about the merits of high-tech voting machines. Touch-screen machines are particularly controversial, since they generally do not produce paper output, cause confusion among voters, and seem to go wrong rather often. It is (just) possible that the 137 undervotes in the Florida case were all cast by voters who deliberately chose to go to the polls, stepped up to the machines, and then decided to abstain. It seems more likely that they pressed the wrong button, or that the machine failed to register their votes properly. But without a paper trail, it is impossible to say.

Machines that do not produce bits of paper verified by voters are also open to the charge that their software is full of bugs, or has been rigged to favour a particular candidate. Stories abound of voting machines producing dodgy results. In one case in Indiana, 5,352 voters somehow cast 144,000 votes. In Virginia, machines subtracted votes rather than adding them to a candidate's total in some cases. Machines have broken down and been taken away, only to reappear with their seals broken; memory cards (on which votes are recorded) have gone missing.

Conspiracy theories have been fuelled by damning memos leaked from Diebold, one of the leading makers of touch-screen voting machines. The firm's voting-machine software, which also leaked on to the internet, was found to contain numerous security flaws.

The Help America Vote Act (HAVA), passed in 2002 in the wake of the Florida fiasco of 2000, was supposed to sort things out by replacing old-fashioned punch-card machines (and their infamous “hanging chads”) with more modern voting equipment. But HAVA has only served to confuse matters further.

The federal government, for good reason, is not allowed to tell the states how to run their elections. Instead HAVA offered $3.8 billion, which the states could apply for in order to purchase HAVA-compliant voting machinery. But the technical committee that is supposed to decide on the HAVA standard has not even been appointed. In the meantime, the money is being doled out to the states anyway. Some of the new equipment purchased meets only the now-obsolete 1990 standard; other machines meet the 2002

standard, which experts also regard as flawed. The result is a mess. Even the regulations surrounding gambling machines are tighter.

Yet there is surely a simple answer: new voting machines should be required to produce a paper output that voters can check. Any funny business, whether accidental or deliberate, could then be exposed by a hand recount if necessary. In November, California became the first state to require that all voting machines must produce a paper trail by 2006. But the debate is far from over.

To begin with, some electoral officials oppose the idea of paper trails on the basis that printers will be too expensive, or they might jam. This strikes Rebecca Mercuri, an electronic-voting expert at Harvard's John F. Kennedy School of Government, as an odd argument: after all Diebold and other voting-machine manufacturers also make cash registers and ATMs, and they seem to work.

Another objection is that voters might walk off with the paper ballots. Dr Mercuri's preferred solution is that voters should be able to see the paper ballot under glass to verify it, after which it drops into the ballot box. Another option would be to use paper forms that voters place under optical readers, which would confirm their choice before the form is placed in the ballot box. The counting is automated, in other words, but not the voting.

It is hardly rocket science. But it is too late to sort out the mess before November, when perhaps 20% of the votes will be cast using paperless touch-screen machines. Worries over their reliability and security, and the lack of a common standard, mean the new machines may have made a Florida-like fiasco more rather than less likely. “We're going to have digital hanging chads,” says Dr Mercuri.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Cowtown in the desert

A new sort of wind power

Jan 22nd 2004 | KRAMER JUNCTION, CALIFORNIA
From The Economist print edition

Getting 90,000 of the creatures to be unsmellily productive

DRIVE an hour east from Los Angeles, then another hour northwards into the Mojave desert, and you will find yourself at Kramer Junction, a dusty California crossroads set amid pale-pastel mountain ranges and a vast blue sky. At first glance, it seems a typical little deep-in-America township, apart from a string of mirrors built down the road in the 1980s to turn the sun's rays into energy. There is a burger place, an antique shop, a couple of petrol stations, a few convenience stores. But now Kramer Junction faces the possibility of an economic revolution.

A pair of Californian entrepreneurs want to turn an empty lake bed just east of town into a non-polluting dairy farm for 90,000 cows, and to convert the cows' prodigious produce of manure and flatulence into a renewable form of energy. This “cowtown”, which will cover 1,900 acres, is the brainchild of William Buck Johns and Henry Orlosky.

Although the cowtown has inevitably attracted some sniggers, not least after America's recent mad-cow scare, many southern Californians see it as a way of dealing with the problem of what to do with California's dairy farms. As suburbanisation barrels ever eastwards from Los Angeles, housing developments have begun to crowd in on Chino, a town 40 miles to the east of the megalopolis. For four decades Chino has been home to some 270 dairy operations with 400,000 cows. But the human newcomers are not fond of their bovine neighbours, who smell foul, mess the water and attract an average of 1,000 flies per cow. The dairy farmers would be happy to sell their land to developers at the grand price they could get—if only they can find somewhere else to take their herds.

The almost empty Mojave desert beckons. Messrs Johns and Orlosky think they have a plan that will ensure that the cows do not damage the desert's fragile ecology, or violate California's tough laws protecting its air and water. In their proposed “cow complex”, the fully enclosed milking areas will be flushed clean of waste every four hours—100lb of manure per animal per day. A “digester” will separate the stinky methane from the largely unsmelly “digestate”. The digestate will be stored and sold to soil-fertilising companies. The methane collected from the manure—as well as from the cows' emissions, front and rear—will run a turbine producing 49 megawatts of electricity.

This electricity will be sold to California's power grid, which not only needs the extra juice but is also under a mandate to increase its purchases of energy made from renewable sources (which cows certainly are). The project may also include a bottling plant, a cheese plant, a meat-packing centre, an ethanol manufacturer and houses for up to 1,000 employees and their families. The whole thing could cost

between $500m and $1 billion.

Mr Johns says that farmers have shown much interest, as have potential buyers of the energy and the complex's other products. And he claims that the mad-cow problem may work to his advantage; consumers will become much more curious about how animals are looked after, and his expensive new kit is much more hygienic than most cow sheds. Eric Lloyd Wright, grandson of Frank, has been hired as the architect.

If it gets the necessary approval, the project could be operating by 2006. The “if”, though, is sizeable. Any scheme involving 90,000 tightly packed cows is sure to draw strict scrutiny. Trucking the cows' food into this desert site could be a headache. Getting the necessary workers to move there may prove daunting. Hinkley, a small community near the proposed site, was the home of the plaintiffs in the legal campaign that made Erin Brockovich famous, so there could be some courtroom skirmishing. Mr Johns, an Arkansan who made a fortune in air-conditioning, promises that people “won't be able to smell anything beyond the property lines.” But he acknowledges that some of the technology will be untested on such a large scale. “We're trying to do something that has not been done before,” he says cheerfully.

Local officials have so far given Mr Johns and his partner the benefit of the doubt. Old-timers in Kramer Junction seem, by and large, to agree. As James Darr, proprietor of Kramer Antiques & Pottery, puts it: “Anyone who can do anything with the desert has our approval.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Lexington

Enter the general

Jan 22nd 2004
From The Economist print edition

Is Wesley Clark facing the wrong way in New Hampshire?

NO REST for the wicked. Almost as soon as Iowa had delivered its shocking result on Monday, the leading candidates were off to New Hampshire. Howard Dean held a rally at 3am (though he was notably subdued for the rest of the day). John Edwards arrived at an equally ungodly hour. John Kerry held his rally at 7am: not only a little more civilised, but perfectly timed for the TV morning news.

All three candidates have found a new threat waiting for them in New Hampshire—a candidate who brings yet another element of complexity and confusion to an already complex race. Wesley Clark, a late entry into the Democratic contest, chose not to compete in Iowa. But he boasts an impressive resumé in an age of terrorism and, thanks to the “Draft Clark” movement, the rudiments of a national campaign. He has used his time in New Hampshire to build a powerful machine, managed by former aides to Bill Clinton, who has advised him.

This political machine was in full display in the Palace Theatre in Manchester on Tuesday night, when Mr Clark gave his response to the president's state-of-the-union address before a huge, hollering crowd. It was perhaps a little odd, given Mr Clark's background, to warm up the crowd with songs from the Beatles' “White Album” (which features such immortal lines as “Hey, Bungalow Bill, what did you kill?” and “Happiness is a warm gun”). But the production still reeked of professionalism.

The audience started off by watching a Clintonian documentary about Mr Clark's life. The young Wesley was raised by his grandparents for a while after his father died. He could have been an Olympic swimmer. He was top of his class at West Point in almost everything. When he went to Oxford as a Rhodes scholar there was rebellion in the air, but for Mr Clark there was nothing but “duty, honour and country”. He was wounded in Vietnam but stayed in the army despite the paltry pay, dining out only at McDonald's, until he eventually became Supreme Allied Commander of NATO and routed freedom's foes.

With his audience's faith in the American dream duly rekindled, Mr Clark then stepped on to a stage that was draped with no fewer than eight American flags. An ever more polished speaker, he duly laid into George Bush for fashioning his own “axis of evil” out of fiscal irresponsibility, foreign adventurism and special interests. And he held out the promise of middle-class tax cuts and the rebirth of a responsible foreign policy. The attempt by his handlers to create a personality cult may be a little eerie, but it sent the audience into a frenzy.

The Clark machine has a good chance of preventing Mr Edwards from building on the momentum of his extraordinary performance in Iowa. Mr Edwards has made much of his ability to win in the South. (“The South is not George Bush's backyard. It is my backyard,” he repeatedly tells audiences, “and I will beat George Bush in my backyard.”) But Mr Clark is both a southerner and a four-star general. He also has a bigger national organisation than Mr Edwards, who is spending some time campaigning in South Carolina when he could be in New Hampshire.

The Clark machine is also a threat to Mr Dean, who for the moment is still just leading the polls in New Hampshire. Mr Clark appeals to a similar (if slightly older) version of the anti-war crowd. He is just as relentless in his Bush-bashing, but his military credentials and support for tax cuts make him look more electable. Some anti-war voters could well switch to Mr Clark—particularly after Mr Dean's somewhat deranged “I fight on” speech to his supporters after his Iowa debacle.

Yet just as Mr Clark is bringing his guns to fire on Messrs Edwards and Dean, he has been caught out by a surprise attack from the rear. His main foe in New Hampshire is surely now Mr Kerry. Having spent weeks preparing for a battle with an anti-Bush zealot who went skiing during the Vietnam war, he is now engaged in a toe-to-toe battle with a war hero who voted in favour of invading Iraq. While Mr Clark has been sliding a point a day in the Zogby poll since Sunday, Mr Kerry has the momentum from his victory in Iowa, and he has an impressive political organisation in New Hampshire. Most of the local Democratic bosses have put their machinery at his disposal. Firemen and ex-servicemen are rolling up their sleeves for him.

Ready, fire, aim

The battle between Messrs Clark and Kerry already has a nasty edge, with both men touting their military credentials. Yet Mr Clark has two big weaknesses in the hard pounding that is to come. The first is the flip side of that sugary documentary. He looks a bit too good to be true: an anti-war general, a former Republican who can appeal to the left, a tax-cutter who wants to improve public services. At some point, voters may ask whether a man who voted for Ronald Reagan but now embraces Michael Moore is a cynical opportunist. Mr Clark's flim-flamming over whether he supported the Iraq war has hardly helped his cause.

His other weakness has to do with the changing terrain. One lesson from Iowa is that Democratic voters seem less interested in national security than in economic insecurity, the rising cost of college and the exploding cost of health care. Yes, Mr Clark can trumpet the fact that, as a four-star general, he was responsible for the education and health of his troops. But his rivals have far more experience of such problems.

To his credit, Mr Clark grasped quickly that his main asset was his electability—the ability to go head-to-head with Mr Bush in the general election. The Democrats seem to be moving in that same direction: the New Hampshire primary seems driven by the methodical search for someone who can send Mr Bush back to Texas. The trouble is that Mr Clark has been positioning himself as a more electable version of Mr Dean. The news from Iowa suggests he may have chosen the wrong model.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Bolivia's troubles

From here to 2007, without falling?

Jan 22nd 2004 | COCHABAMBA AND LA PAZ
From The Economist print edition

An accidental president tries to soothe a discontented country

Get article background

WHEN Carlos Mesa was sworn in as Bolivia's president after a popular revolt last October had toppled Gonzalo Sánchez de Lozada, it seemed he would be lucky to survive more than a few months. Yet he clearly does not see himself as just a caretaker. Mr Mesa, an articulate former television journalist and historian, began this year by telling Bolivians that he wants to serve out Mr Sánchez's full term until 2007. In a long and didactic address, he said bluntly that Bolivia's main problem was that the relationship between state and society had broken down.

Indeed so. Bolivia, South America's poorest country, has become a source of worry to its neighbours—and to the United States. George Bush met Mr Mesa at an Americas summit last week. On January 16th, the American and Mexican governments organised a meeting in Washington to drum up aid. “We must help Bolivia...lest its citizens' hopes for a better life turn to despair and they question the legitimacy of democracy itself,” declared Colin Powell, the American secretary of state.

Between the mid-1980s and 1999, Bolivia enjoyed political stability and moderate economic growth, thanks partly to liberal reforms championed by Mr Sánchez in his first term, from 1993 to 1997. But then the economy followed its neighbours' into stagnation. A successful American-backed drive to eradicate coca (and so cocaine) in the Chapare region added to the slump, and corruption and spoils-sharing undermined public support for the political establishment. Elected again in 2002 with a weak mandate, Mr Sánchez, a pro-American mining magnate, was undone by opposition to a scheme to let multinationals export natural gas to the United States through (former Bolivian territory in) Chile. At least 59 people were killed in October when Mr Sánchez used the army to break a blockade of the capital, La Paz, by Indian farmers and slum-dwellers.

Mr Mesa, who was Mr Sánchez's vice-president, has tried to soothe the wounds. He has appointed a non-party cabinet. Unlike Mr Sánchez, he is popular (liked by more than 80% of Bolivians, says one poll). But he faces the same underlying problem that defeated his predecessor: how to stimulate investment and

restore order to the public finances in the face of the demands of radicalised social groups. His answer is a moderate nudge to the left.

Ironically, the heat has gone out of the gas issue. Sempra, an American company, has signed a contract to import gas from Indonesia instead of Bolivia. “A door has shut for us, and to deny it would be absurd,” says the president. Instead, he is trying to win over the gas industry's critics. He has offered free gas connections for 200,000 families, and wants to increase taxes on foreign gas companies while reviving the state oil and gas firm, whose assets were privatised by Mr Sánchez. He hopes these proposals will be enough for the government to win a promised referendum on energy policy in March.

Mr Mesa has also given in to a demand for a constituent assembly. Bolivia's current constitution dates from 1994; many might think it requires only minor changes. Not Evo Morales, the radical leader of the coca workers, who came a close second to Mr Sánchez in the 2002 election and who has influence among the protesters. “We want to begin again with the constitution, to refound the country,” he says. Though he claims he favours a “mixed economy”, much of what he says smacks of utopian socialism. Mr Morales is a friend of Venezuela's populist president, Hugo Chávez, and the focus of American worries about the country.

Mr Mesa wants to put off elections to the assembly until after local polls due in December. This would give time for the traditional parties to reorganise and, perhaps, for the economy to revive. But time may not be on Mr Mesa's side. “Is it possible to govern without political parties?” he asks. “It is very difficult. There are no precedents for this in Bolivian history.”

If the parties recover, Mr Mesa says he would put together a national-unity government. But the economy may not help their revival. Political uncertainty slashed local private investment to just 1% of GDP last year, compared with more than 5% in 1999, says Juan Antonio Morales, the central bank's governor. The loss of the American gas contract and the proposed tax rises will deter energy investment. To make matters worse, heavy rains this month destroyed a key bridge in the east (see picture). Even so, Mr Morales reckons the economy could grow by about 3.5% this year, its best performance since 1998, thanks to high mineral prices, textile exports to the United States, and recovery in Brazil and Argentina.

AP

The underlying problem is that Bolivia's exports, tax revenues and productivity are all low. The fiscal deficit climbed to around 8% of GDP in 2003. Mr Mesa needs $100m by March and a further $300m by December just to pay the government's bills. If the taxpayers do not provide, aid donors will have to stump up.

In return for their money, the Americans want Mr Mesa to continue the drug war. They say that Bolivia's coca output rose by 23% last year. Most of the new planting is in the Yungas, where coca is grown legally for traditional uses, such as tea and chewing. Mr Mesa says that before eradicating this coca, he wants a study of how much is needed for traditional uses; he would prefer to remove the excess by negotiation. The American position is “less flexible”, he says.

A new drug war risks a new confrontation with Mr Morales and his coca unions. For now, Mr Morales is quiescent. He says he agrees with the president on one thing: the defence of democracy. But others are restive, and are talking of new protests unless Mr Mesa brings forward the election to the constituent assembly. For all the president's soothing charm, his country may not remain calm for long.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD THE AMERICAS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Mexico

Turtles in the soup

Jan 22nd 2004 | MEXICO CITY
From The Economist print edition

An unequal struggle on the beaches

THERE are few sights in nature as awe-inspiring as a giant sea-turtle lumbering up a moonlit beach to lay its eggs. Looking every bit as ancient as they often are, the turtles spend hours digging a deep hole with their powerful flippers, into which they will drop over 100 eggs at a time. There are few countries they like better than Mexico with its abundance of beaches, especially on the Pacific coast, and, since 1990, a law to protect the turtles.

But the law is not being respected. Last week, Profepa, Mexico's environmental protection agency, claimed that turtles were being slaughtered to feed a smuggling network similar to those of drug traffickers (such networks often overlap). The incentives are obvious. After killing a defenceless turtle on a remote beach with little possibility of getting caught, the gangs can sell the skin, eggs and meat on the black market.

Officials are particularly concerned by a new gang in the state of Guerrero, which slaughters turtles on the beaches north of the seaside resort of Acapulco. Known as Los Nejos (after a maize dish), the gang numbers fewer than ten and operates on horseback, but is armed with automatic rifles. It has driven off environmental activists, who claim it may have killed more than 500 turtles in the past two months.

Turtle skin may end up on a pair of cowboy boots that will sell for at least $85 a pair in Mexico. The price can rise to $200 a pair if they follow the drugs over the border into the United States. The eggs, too, are prized. Profepa has detected a well-established pipeline from Mexico's south-eastern beaches to the capital, where the eggs are sold under the counter at markets and restaurants. Last year the authorities seized 135,000 turtle eggs.

Turtle meat is also in demand, especially along the Pacific coast. It is an illicit, tasty and expensive favourite at weddings, birthdays and other family events, calculated to impress the neighbours or the in-laws. Profepa concedes that turtle meat is also used by politicians to woo potential voters at campaign dinners. Pity the poor turtles for getting so mixed up in politics.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Central America

Capitalism in the raw

Jan 22nd 2004 | SAN SALVADOR
From The Economist print edition

Labour rights and free trade with the United States

AP

Stitching up the shopfloor

EVERY weekday, Dora Amelia Ramos, a single mother, leaves her breeze-block home in a village south of San Salvador at 6am to go to her job at a *maquila* factory making clothes for export from imported cloth. Earning the minimum wage of just over $5 a day, she is perched on one of the lower rungs of the world economy. But she counts herself lucky to have a job at all. That is because she is a trade unionist.

This year people like Ms Ramos will be the object of fierce attention in Washington, DC. Last month El Salvador and three other Central American countries concluded talks for a free-trade agreement with the United States. This week American officials tried to wrap up a similar deal with Costa Rica, the isthmus's richest economy. Once that is done, the Central American Free-Trade Agreement (CAFTA) will go to the countries' respective congresses for ratification.

In the United States CAFTA is controversial. Lobbyists for some textile and sugar producers oppose it (see article). Their aim is to protect their own uncompetitive businesses. To do so, they will pick on labour rights.

The trade agreement requires countries to enforce their own labour laws, and to “strive to ensure” that those laws uphold international labour standards. For opponents, such as Sander Levin, the senior Democrat on the House of Representatives' Ways and Means Committee, this is far too weak. His committee will scrutinise the treaty, probably in early summer. He argues that labour laws in Central America are “way off the mark compared to international standards”. The treaty will be “politically unsaleable to workers in the United States who have to compete with suppressed workers in other countries.” Mr Levin threatens to throw out CAFTA unless “meaningful labour agreements” are added, by which he means fines and penalties for breaching agreed standards.

His fears are echoed by opponents in El Salvador. They claim an influx of new *maquila* jobs will lead to a further deterioration of working conditions. Ms Ramos says these are already bad. In her last job, at Confecciones Niños, a textile factory in a free-trade zone owned by a former general, she says she was often denied drinking water, bathroom visits and time-off to see a doctor. Her wages were paid late, and overtime not at all. She adds that when she tried to form a union, she was threatened with the sack and blacklisting. All of this breached the country's labour laws.

Ms Ramos's experience is far from unique, according to recent reports by Human Rights Watch, a New York-based group, and the National Labour Committee, in Washington, DC. Some Salvadoreans agree. There is “a total neglect of labour rights by the state here,” says Carlos Aristides Jovel, a labour-court judge. The independent ombudsman for labour rights complains of a “lack of political will” to enforce them. Workers in *maquila* plants often lack contracts, say the critics.

Individual abuses may exist, says the government, but it disputes such general criticisms. Jorge Nieto, the minister of labour, brandishes a book-length certificate from the International Labour Organisation to prove that the country's labour laws do meet international standards. He disputes the ombudsman's claim that government labour inspectors are too few (there are 62, for a workforce of 2.6m) and too corrupt.

El Salvador is one of Central America's more modern economies. Conditions in poorer Guatemala and

Honduras are probably worse. But the wider question at stake is how to remedy the abuses, where they exist. Better enforcement of national laws is important. Supporters of CAFTA also argue that the trade accord will bring more investment and more jobs to Central America, driving unemployment down and wages up and thus encouraging bosses to treat their workers as assets rather than pawns. Is that what the opponents want to prevent?

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Canada's economy

The loonie flies too high

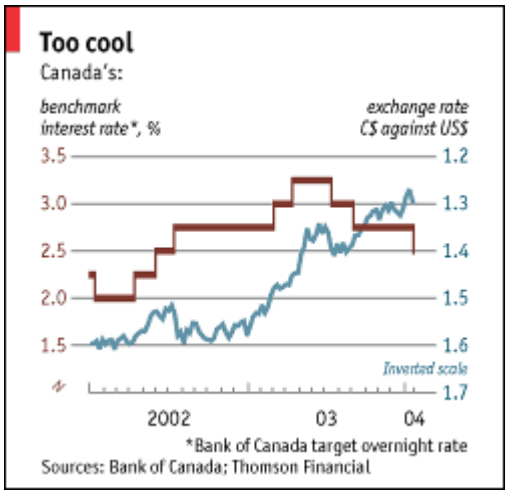
Jan 22nd 2004 | TORONTO
From The Economist print edition

Coping with a strong currency

Get article background

STEERING Canada's economy towards recovery is proving as tricky as driving a car on the icy streets of its cities. Just a year ago, economic growth outstripped that of the other main industrial countries. But since then it has disappointed, slipping to only about 1.5% in 2003. Adjusted for inflation, that is only about half the rate in the United States. So while the Federal Reserve ponders when to raise interest rates to keep inflation in check, the priority north of the border has turned to economic stimulus. On January 20th the Bank of Canada lowered its key overnight interest rate from 2.75% to 2.5%. Not only has demand been "somewhat weaker than projected", said the bank, but sustained recovery could be at least a year away. Many now expect another rate cut in March.

Economic misfortune of one kind or another struck almost every corner of Canada in 2003, from the SARS virus in Ontario and mad-cow disease in Alberta to hurricanes in the Atlantic provinces and forest fires in British Columbia. But by far the sharpest brake on growth has been the soaring Canadian dollar. The loonie—which takes its nickname from the aquatic bird depicted on the $1 coin—has climbed to its highest level in more than a decade (see chart). Global Insight, a consultancy, estimates that Canada's growth this year would be a worthy 5% at an average exchange rate of 65 American cents. Instead, it forecasts 3.4%.



The United States buys 85% of Canada's exports. The central bank had hoped that accelerating demand from south of the border would offset the lower export margins and stiffer competition from imports that result from a strengthening currency. But southbound shipments have shrunk in three of the past four months. Canadian firms' market share is being eroded by other suppliers, especially from Mexico and China, whose currencies either are fixed or have risen more slowly against the American dollar. Though the strong currency may eventually encourage Canadian businesses to become more competitive by importing the latest machinery and technology, the speed of the loonie's appreciation has made it difficult for many to adjust.

The stalled economy is also prompting a fiscal rethink. For the past decade, balanced budgets have been a mantra for the federal and the provincial governments alike. But now tax revenues are slowing while demands for new spending, especially on health care, grow. Federal spending has jumped sharply over the past four years. Provincial surpluses have vanished. Ontario, the most populous province, faces a deficit of over C$5 billion ($4 billion) in the fiscal year to March 31st. That is a far cry from the surplus promised by the Conservative government tossed out of office in the province last October. Only Alberta, flush with oil and gas royalties, is likely to remain in the black over the next few years.

The federal government hopes for a surplus of at least C$2.3 billion this fiscal year. Paul Martin, Canada's new prime minister, has already earmarked the first C$2 billion of this for extra health spending by the provinces. But hard-pressed cities want billions of dollars in infrastructure grants and a share of petrol taxes. Mr Martin also plans to strengthen defence. "The political battleground will be government spending," says Tom d'Aquino, president of the Canadian Council of Chief Executives, a business lobby group.

The government insists that it will stick to the policy of budget surpluses and debt reduction set by Mr Martin when he was finance minister from 1993 to 2002. To that end, the new finance minister, Ralph Goodale, has frozen most capital projects and launched a top-to-toe review of government spending.

What if growth remains sluggish, as the Bank of Canada thinks it may? According to a recent opinion poll, Canadians would rather see a return to fiscal deficits than big cuts in spending programmes. That may influence Mr Martin, who is expected to seek his own mandate by calling a general election in the spring. Could it be that Mr Martin, the prime minister, will turn out to be a bigger spender and heavier taxer than Mr Martin, the finance minister?

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

North Korea

Playing with plutonium

Jan 22nd 2004
From The Economist print edition

Bomb, or no bomb? Deal, or no deal? The latest twist

Get article background

AFTER more than a decade of dealing with a North Korea that might already have a bomb or two—no one has known for sure—does it matter that it is now claiming to be ready to build more? It certainly seems to matter a lot to North Korea that America takes its nuclear threats seriously.

Hence the invitation to a private American delegation earlier this month to view what North Korean officials said was bomb-usable plutonium recently extracted from the 8,000 spent fuel-rods previously stored in a cooling pond adjacent to North Korea's nuclear reactor at Yongbyon. The aim was probably to strengthen North Korea's hand ahead of a round of six-way talks (to include South Korea, Japan and Russia) that China hopes to convene next month. North Korea may also be hoping that fears about what it may do next with its plutonium will widen splits between the other five at the negotiating table. Will the gambit work?

This week, Siegfried Hecker, a retired nuclear scientist in the touring party, said publicly for the first time that, from what he had now seen, North Korea could probably make plutonium metal (not a technically complex process), but that he had come across nothing on this visit to confirm that it could turn such material into usable bombs. And that was as far as he would be drawn.

North Korea, however, reportedly told America in private last April that it already had nuclear weapons and might test one, or sell one, as it chose. According to Charles Pritchard, a former State Department official, North Korea's deputy foreign minister, Kim Gue Gwan, told this month's visitors that any delay in reaching a nuclear deal would simply increase “the quantity and the quality” of North Korea's nuclear deterrent. A report by a London-based think-tank also concludes that North Korea is probably able to produce nuclear weapons and could be expected to do so (see article).

But while North Korea is playing up its plutonium proficiency, it is now denying what it admitted to an official American delegation (which also included Mr Pritchard) with intelligence evidence in its pockets in October 2002, namely that it had secretly started a programme to enrich uranium—another potential bomb ingredient. That reluctant admission sparked the latest nuclear crisis and ended a 1994 agreement

with America that aimed to swap the eventual building of two western-designed nuclear reactors and interim deliveries of fuel oil for a halt to, and the eventual dismantling of, North Korea's plutonium making. Shipments have been intercepted containing parts for such a uranium venture. Yet Mr Kim now says that North Korea has “no programme, no equipment, no scientists trained” in uranium enrichment.

Why the backtracking? American officials suspect that North Korea is trying to wriggle free of President George Bush's demand for the “complete, verifiable and irreversible” end to all its nuclear programmes. Back in 1994, in agreeing to a plutonium freeze, North Korea balked at proper inspections. The suspicion then, that it wanted to keep its nuclear option open, has since proved all too accurate. Now it has offered to refreeze its plutonium-making, albeit in return for non-aggression promises and lots of other goodies. But the uranium denial suggests it is up to its old tricks.

Flexible South Korea, firmer Japan

Its intransigence may be having some effect. China, its diplomatic patience thinning as it struggles to broker a deal to end the stand-off, has suggested that America may have the uranium story wrong. Dealing just with the plutonium problem is evidently proving hard enough. South Korea, though it officially supports the denuclearisation of the peninsula (or rather prefers not to acknowledge that North Korea's nuclear boasts may be true), would also prefer to take a more flexible line, offering more inducements to North Korea in the hope of better relations. Last week South Korea's foreign minister was sacked; some officials in his ministry had evidently criticised what they saw as the all-too North Korea-friendly policies of the president, Roh Moo-hyun.

The country that has stuck closest to America's firmer line is Japan. Alarmed by North Korea's threatening behaviour, it is now a keener participant in missile-defence projects with America and has joined the proliferation security initiative, a multi-country effort to block illicit weapons shipments, including any to North Korea. It may soon debate new laws making it easier to take economic and financial measures should North Korea continue with its nuclear threats.

But the issue that has most enraged the Japanese public is North Korea's admission that it had abducted a number of Japanese citizens to help train its spies. Now North Korea is apparently offering to let the families of some of those it abducted and who are now back in Japan join them there. A conciliatory gesture, or another attempt at diplomatic wedge-driving? Either way, America is still adamant that any deal must end North Korea's nuclear antics for good, or it won't be worth having.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

North Korea

Nasty weapons

Jan 22nd 2004
From The Economist print edition

North Korea's arsenal

Get article background

WHAT weaponry does North Korea have? This is the latest answer from the International Institute for Strategic Studies in London:

Nuclear

•North Korea could have produced enough plutonium before 1992 for one or two nuclear weapons.

•Besides that, it has enough additional plutonium for two to five nuclear weapons, and could in a few years be producing five to ten weapons a year.

•It is likely to have embarked on a clandestine enrichment programme, though its status and possible time of completion remain unclear.

•With enough fissile material, it could design and fabricate a simple implosion device, based on either plutonium or highly-enriched uranium, without a full nuclear test.

Chemical and biological

•North Korea has probably produced and stockpiled chemical weapons, but there is uncertainty about the amount and types of agents produced, as well as the size of any stockpile.

•It has conducted research and development on biological agents, but it is unclear whether it has produced any or put these on weapons, although it is probably capable of doing both.

Missiles

•As demonstrated by a 1998 flight test, North Korea has begun to pass technological hurdles to develop multiple-stage long-range missiles.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD ASIA

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Myanmar

Some peace, no development

Jan 22nd 2004 | YANGON
From The Economist print edition

Grand plans, but not much hope in sight

Get article background

THE State Peace and Development Council, as Myanmar's military regime styles itself, is at least living up to one part of its name. Over the past decade, the council has concluded ceasefires with almost all of the country's myriad rebel groups. The last big one still fighting, the Karen National Union, currently has emissaries in Yangon, the capital, negotiating a truce. Despite the advent of peace, however, the regime is still struggling to provide the development it advertises. And democracy does not feature in its name at all—nor, it seems, in its plans.

Theoretically, a ceasefire with the Karen will pave the way for a constitutional convention, at which Myanmar's many ethnic groups and political parties will have their say. The resulting document will be put to a referendum, in time to usher in some form of democracy before 2006, when Myanmar takes over the rotating chairmanship of the Association of South-East Asian Nations.

So, at least, suggests the junta's cheery “road map” to democracy. But observers in Yangon are less sanguine. The government has released 26 political prisoners this month, but it still holds over 1,000 more. It has also had Aung San Suu Kyi, Myanmar's leading dissident, again under lock and key since a crackdown last May. That was just the latest of many blows to her National League for Democracy since the generals annulled the 1990 election that the NLD had won by a landslide.

There are signs that the road map, too, will lead nowhere. The junta is insisting that the armed forces appoint a quarter of all the seats in any future parliament and a third of the seats in the regional assemblies. Its courtship of ethnically-based groups like the Karen National Union looks designed to isolate the National League for Democracy. It also wants to ban people with foreign spouses or children, such as Miss Suu Kyi, from the presidency. Since its crackdown on her party last year seemed to be a response to the efforts to re-establish the party's long-suppressed regional offices, there seems little chance that it will allow a proper debate on a new constitution, let alone free elections.

Most people in Myanmar, however, have more mundane concerns, such as the price of rice. The authorities liberalised the rice trade last year, but on January 1st they changed course, banning exports for six months—presumably to ensure adequate local supply and low prices. The result is a huge glut. The price has fallen below the cost of production, badly hitting the 70% of the population who live off the land.

Other recent initiatives include punitive car taxes, despite a grave shortage of vehicles. The government also helped to bring about a bank run last spring, leaving the urban economy in chaos. Since then American sanctions, imposed after the latest crackdown on Miss Suu Kyi's party, have put some 40,000 clothing employees out of work and made some foreign transactions such as credit-card payments very difficult. But even before the sanctions came into effect, businessmen were leaving the country, fed up with the government's arbitrary economic management.

Nonetheless, the economy has always staggered on in spite of the government, and the junta has revenue from natural-gas exports to tide it over: a Korean-led consortium has just discovered a big new offshore field. Ministries are being encouraged to become financially self-sufficient by selling services or going into business. And if all else fails, the government can always resort to its tried and tested tactic of printing money. Yet in the back of their minds the generals must remember that it was protests over economic policy, not politics, that brought down the military regime in 1988. Could it happen again?

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

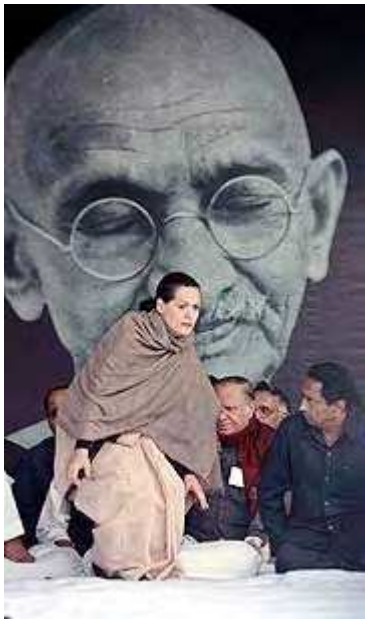
India's politics

The unlikely heiress

Jan 22nd 2004 | DELHI
From The Economist print edition

Can Sonia Gandhi lead Congress to victory?

AP



Trying to carry the flame

IT IS all a question of branding. Is Sonia Gandhi, the Italian-born president of Congress, India's main opposition party, marketable as the heiress of the Nehru-Gandhi dynasty, or will her foreign origins turn off India's 650m voters? India's forthcoming general election, now expected in April, will see Mrs Gandhi, an inexperienced politician, competing against Atal Behari Vajpayee, the politically savvy prime minister. His Bharatiya Janata Party certainly intends to make Mrs Gandhi's origins an issue in the election.

Mrs Gandhi is a reluctant recruit to politics, as was her husband Rajiv, assassinated in 1991. But Rajiv Gandhi was the grandson of Jawaharlal Nehru, India's first prime minister, and the son of Indira Gandhi, the prime minister murdered in 1984. He had no difficulty leading Congress to victory after his mother's death. Whether his widow can turn the thousands who come to see her into votes is still uncertain.

Since she became politically active as Congress president in 1998, Sonia Gandhi has failed to emerge as an effective leader. She has been shielded from public exposure by a coterie of advisers and sycophantic hangers-on. Believing that she might not survive politically in the public glare, party officials hoped that Congress would inherit power by default when Mr Vajpayee's coalition collapsed. But the coalition has not collapsed, and Congress fared poorly in recent local elections.

There has been “ineffectual communication of what she stands for, so she has been robbed of any equity brand or identity,” says Suhel Seth of Equus, a Delhi-based branding company, who advises politicians. More simply, “She is seen as an Italian pretending to be an Indian politician.” It is not even clear whether she expects to become prime minister. Her official line is that this will be decided after the polls. The party's politicians, however, insist they expect her to have the job if Congress wins over 180 seats in parliament—it took 112 out of 545 in the last election, in 1999—and secures enough coalition allies.

Politicians close to Mrs Gandhi say she has little-known virtues. Kapil Sibal, a Congress spokesman, says she would be “a more honest, secular and forthright prime minister than Vajpayee.” Ashwani Kumar, a lawyer who runs a party think-tank, says that family members “are relevant because they are the symbol of sacrifice and continuity in the history of Congress and modern India.” But his argument is unlikely to mean much to India's emerging young middle class.

The line does not end with Mrs Gandhi. Her son and daughter, Rahul and Priyanka, so far not active in politics, have just visited two family-linked constituencies in Uttar Pradesh. Priyanka Gandhi is expected to become a parliamentary candidate there, and her brother may also stand, perhaps in Tamil Nadu in the south. The party believes this would help, especially if Mrs Gandhi becomes more approachable. She has embarked on a rural tour and broken with tradition by visiting potential allies to ask them to join a coalition, instead of waiting for supplicants. But time is short for image-transformation—especially when the marketability of the basic brand is in doubt.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Japan's press

Members only

Jan 22nd 2004 | TOKYO
From The Economist print edition

Why the press-club system should be abolished

A BITTER battle between the head of the biggest highway-building state corporation and the minister who wants to sack him is big news in Japan. Yet when Pio D'Emilia, a correspondent for an Italian newspaper, tried to attend a public hearing on the matter, he was ejected none-too-gently from the building. Bureaucrats told Mr D'Emilia that only members of the construction ministry's *kisha* (journalist) club were allowed to attend.

Such treatment of foreign journalists, but also of local magazine reporters and freelancers, is common in Japan. British reporters flying to Japan to cover the investigation into the murder of Lucie Blackman, a young English woman who disappeared in 2000, were stunned when *kisha* clubs refused them access to police briefings. The practice has become a trade issue: the European Union calls it a “restraint on the free trade of information” and has urged its abolition, as it will again in Brussels in February in its next round of regulatory-reform talks with Japan.

The thousand-odd *kisha* clubs in Japan, filled with reporters from domestic newspapers and television stations, are in the government offices, police stations, courts and commercial organisations that they cover. Their hosts, who provide them with rent-free space, give club reporters first dibs on all information they want released to the public. Clubs can bar non-members from attending or asking questions at press conferences. Sometimes, they even control access to documents supposedly in the public domain. This leads to peculiar situations in which non-members asking for transcripts from, say, a public prosecutors' office, are told to get in touch with the relevant *kisha* club instead.

Getting membership is not easy. Most *kisha* clubs require half or two-thirds (or in extreme cases, all) of its members to approve applications. Not that opening the doors to *kisha* clubs is a solution: many foreign news organisations are represented by only one reporter, who can hardly be expected to join hundreds of clubs just to obtain information. Rather, the exclusive link between the hosting organisations and *kisha* clubs should be broken, says Etienne Reuter, spokesman for the European Commission delegation in Japan.

Local readers suffer, too. The proximity of *kisha* club members to the people they cover creates chummy relationships that make it hard for reporters to write critical stories, says Akira Uozumi, a freelance reporter who worked for 20 years at Kyodo News, a wire service and *kisha*-club regular. By providing easy and exclusive access to news, the government has created a tame press, which, say critics, can sometimes be persuaded to sit on awkward information. Often, too, *kisha*-club members, whose job is to sit and wait for titbits of information and want to justify their doing so, are loth to share stories with colleagues in their head offices. The upshot is bland and one-sided stories.

Though Yasuo Tanaka, the controversial governor of Nagano prefecture, broke from tradition by opening up press events to all journalists and the public after his election in 2001, few others have followed suit. That may be one reason why a number of foreign newspapers have recently closed their offices in Tokyo. Yet most Japanese do not even know of the controversy surrounding the *kisha*-club system. Strangely, the conflict with the EU has failed to get coverage in the local press.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD ASIA

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

China's property market

Castles in the sky

Jan 22nd 2004 | BEIJING
From The Economist print edition

A boom in luxury homes

CHATEAU REGALIA, a cluster of villas and apartments north-east of Beijing, calls itself an “extravaganza for the nobility”. A “duke” five-bedroom house with swimming pool costs $1.5m or so. Lesser ranks can settle for the marquis, earl or viscount types for a mere $720,000—roughly 730 times as much as the average urban Chinese earns in a year. Riff-raff are carefully kept outside the compound's guarded gates.

In the past few years, residential areas of ostentatious luxury have proliferated in and around many Chinese cities. These compounds of eclectic architecture (with imposing classical columns a particularly favoured feature) vie with one another for exotic or downright absurd names—from Yosemite to Merlin Champagne Town—that set them apart from the drab villages and featureless rural landscape in which they are incongruously set.

Equally striking are the number of partially completed complexes that developers have simply abandoned. Even in Beijing, where rich expatriates and members of China's new business elite combine to boost demand for swanky accommodation, many villas and unadorned concrete frames stand empty and unattended. Near the town of Langfang, about 120km (75 miles) from Beijing, a foreign-run orphanage has persuaded a developer to let it use part of a near-deserted compound. The children now enjoy the run of villas called House of Love and House of Joy.

The building of villas that are never lived in is more than simply a mismatch between supply and demand, although some analysts do worry about a supply “bubble” in the luxury-housing business. It is what results when an industry is driven by an abundance of cheap land, cheap labour and easy credit. Close to Chateau Regalia is a small cluster of boarded-up villas whose developer discovered only after they were built that they lacked the necessary permits from the government. Shoddy workmanship or lack of nearby amenities also make some unsellable.

Last year China began trying to impose more discipline. An indefinite ban was imposed on the further sale of land-use rights for luxury housing. Banks were ordered to lend only to credit-worthy developers. Bigger down-payments were required for buyers of luxury housing, and mortgages for uncompleted properties were banned. To shed more light on the market, the National Bureau of Statistics published for the first time figures for the number of villas and luxury apartments: 97,751 were completed in 2002, a 35% increase over the previous year and well over twice the 1999 figure. Beijing alone accounted for nearly 10% of those built.

Will all this make a difference? The restrictions on land acquisition could be good news for developers who have been hoarding land and already have permission to build. But Wang Lina, a property pundit at the Chinese Academy of Social Sciences, sees a “bitter” year ahead for developers as the new credit-rating system forces them to think before they build. This could be bad news for the architecture students whose cheap designs have lent a surreal touch to China's urban landscape.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

China

Hitting the slopes

Jan 22nd 2004 | BEIJING
From The Economist print edition

Beijing's new entertainment

THOUSANDS of residents of the Chinese capital will celebrate the start of the Lunar New Year by heading to the ski-slopes. Never mind that Beijing's desert-like climate rarely produces snow. It is cold enough in winter for snow-making machines to spray the bare hills north of the capital with adequate covering. And the rapid growth of a pleasure-seeking middle class has created the basis for this new fad.

AFP

A future champion

Since Beijing's first ski slope was opened five years ago, the sport has enjoyed an astonishing boom. There are now more than a dozen slopes. Clothes markets in the city have added vivid coloured ski suits to their winter wear collections. Qiao Wei, the deputy general manager of newly-opened Beijing Jundushan ski resort, cannot name a single well-known Chinese skier. But he sees the growth of an industry that could soon encourage Chinese to head for the ski resorts of Europe. In recent years many ski resorts offering natural snow have opened in China. But most are in remote and backward parts of the country that can hardly match the facilities and snob appeal of some of their foreign counterparts.

Beijing's skiing craze has been boosted by the recent surge in private cars. This has generated the growth of a leisure industry in the capital's rural suburbs, which until the late 1990s were mostly inaccessible to ordinary residents. Mr Qiao reckons about 40% of the visitors to his resort (out of 2,000-3,000 on good days) come in their own vehicles. The rest are bused in by schools, businesses or government offices.

The problem is making money. Creating ski slopes requires a considerable investment: renting land from rural governments, preparing the slopes, buying snow machines, ensuring a good supply of water (not easy in desiccated Beijing) and electricity to run them, and buying ski gear for hiring out to customers. The Jundushan resort, a private development, cost nearly $4m to set up. And, as so often in China when someone comes up with a good idea, competitors rush in and price wars break out. Beijing now offers some of the cheapest ski coaching in the world—though with almost everyone rather new to the sport, expect a few collisions.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Democratising Iraq

Elections or caucuses?

Jan 22nd 2004 | BASRA
From The Economist print edition

AFP

The Americans face some awkward choices in their quest for democracy in Iraq

Get article background

IF THERE is one factor that just about all the rivals for power in Iraq acknowledge, it is that the United Nations must play a big part in giving legitimacy to whoever rules the country. It was to this end that America's proconsul in Iraq, Paul Bremer, and a delegation from Iraq's American-appointed Governing Council went to New York this week to appeal to Kofi Annan, the UN's secretary-general, for his organisation to return to Iraq and oversee a transfer of power from the Americans to a selected group of Iraqis by July.

At the same time, on their clerics' orders, Iraq's Shia Muslims were marching in their tens of thousands, demanding a direct election, to be monitored by the UN; a national assembly is due, under the current timetable, to be chosen by the end of May. In August the UN lost its head of mission, Sergio Vieira de Mello, and 21 others in a bomb blast, after which it withdrew. Mr Annan has been in no hurry to send a team back. A huge suicide bomb in a car outside the Baghdad headquarters of Mr Bremer's Coalition Provisional Authority (CPA) on January 18th killed at least 25 people, all but two of them Iraqis. The single most lethal attack in Baghdad since the Americans took over, it reminded the UN how dangerous Iraq still is.

Even so, Mr Annan has agreed to send a mission to investigate. Time, however, is short. Under Mr Bremer's timetable, announced in November, barely four months remain before a transitional national assembly is to take shape, and no one agrees on how to choose its delegates. Mr Bremer wants a series of provincial caucuses, with members vetted by the CPA, to select delegates. The country's most powerful Shia cleric, Grand Ayatollah Ali Sistani, wants a full-scale election. Backers of the former regime are delighted by the prospect of political mayhem.

Since the Shias make up about 60% of Iraqis, Mr Sistani probably has majority support in the country. But many secular-minded Iraqis, including quite a few Shias, fear that he may be another Ayatollah Khomeini in sheep's clothing; they recall that Iran's chief mullah adopted the language of human rights as he swept the despotic shah from power 25 years ago. Only days before Mr Sistani's recent démarche, his allies on the Governing Council had voted to replace Iraq's civil code, which gives women broad rights in matters of divorce, with Islamic family law. Under the clerics' guidance, far fewer women now drive cars than before the war, and the vast majority of female civil servants in ministries run by Shias are now veiled. Many secular-minded Iraqis are queasy about an election that might give a Shia cleric a veto

over how the country is run.

Yet in many ways the Americans seeking to install democracy in the Middle East should be pleased. It is not often in the Arab world that a declared democrat has commanded such popular support. In a dress rehearsal for the pro-election rally, a few boys did don white funeral shrouds as a warning that if America did not do Mr Sistani's bidding, they might join the ranks of the suicide bombers. But until now the *Hawza*, the Shia clergy's highest establishment, based in Najaf, their holiest city, has shepherded its flock on a peaceful path. It has used non-violent methods of persuasion: street demonstrations and the threat of strikes and non-cooperation.

Nor, so far, does the CPA fear that Mr Sistani has a secret agenda for taking over. A CPA man who has often met him says the ayatollah is adamant that religion should be separate from politics, even over matters of religion itself. “Whoever you nominate, make sure he's not wearing a turban,” he quotes Mr Sistani as saying.

The beards have it

To outsiders, the *Hawza* is a hierarchical order that gives authority to a papal figure, often by nepotism. To insiders, it is highly democratic. Every Shia layman chooses his own ayatollah, whose authority is determined partly by the size of his following. Iraq has at least four “grand ayatollahs” but, because Mr Sistani is plainly the most popular, he is deemed “supreme”. In a sense, there is an election every day.

Moreover, among the 100,000-plus marchers in Baghdad were quite a lot of Sunni Arabs too. Some senior people from Saddam Hussein's Baath Party were also there, perhaps hoping to use new freedoms to subvert the new order. “We accept that the next president will be Shia,” says Mishaal Jabouri, whose party represents Sunnis from Mr Hussein's heartland in the Tigris valley north of Baghdad.

Mr Sistani has also begun to win a few influential people within the CPA to his cause. Mr Bremer had insisted that there was not enough time, technical wherewithal or security to hold an election before the scheduled handover to Iraqis by July 1st. But in the face of Mr Sistani's stubbornness he has agreed to a clutch of adjustments, so far unspecified, to his caucus method. In the more stable south, it is clear that a direct poll for the national assembly would not be as hard as Mr Bremer has claimed. Some in the CPA reckon that the country will grow more violent if Mr Bremer insists on sticking to his method without a popular (read clerical) mandate.

In the absence of clear instructions from the CPA in Baghdad on how to prepare for the caucuses, the British-led administration in Shia-dominated southern Iraq has drawn up a “working hypothesis” for managing an election. Under Mr Bremer's current plan, each of Iraq's 18 provinces would choose a caucus of notables to select representatives to the national assembly. Town councils, provincial councils and the Governing Council in Baghdad would each nominate one-third of every caucus. British officials running Basra say that municipal and provincial elections could be held to choose the council nominees, so two-thirds of each caucus's members would be elected.

Find the wiggle room

One option for placating Mr Sistani and the Shias, say British officials, is to ask the Governing Council to waive its share of delegates. But its councillors, many of them returned exiles who have some power but no evident following, are loth to agree. As a variation on the original plan, Governing Council members might be asked to appoint members of minorities, as well as women, to the caucuses, to ensure the widest possible representation.

To answer Mr Bremer's complaint that Iraq lacks an electoral roll, the British say that in the four southern provinces under their control they could let people who own identity and health cards vote as well as those with ration-cards. Dye could be put on voters' hands, as in rough-and-ready elections considered valid elsewhere around the world, to ensure that people do not vote twice.

Not all Iraqis would be happy. The Kurds, for instance, are reluctant to have an early election that might reduce their influence. The insurgents in the Sunni provinces in central Iraq might intimidate or even kill those who tried to vote. Caucuses, by contrast, might be more easily protected. “Who would want to oversee a voting booth in Mr Hussein's home town, Tikrit?” asks a CPA official.

That is the sort of question that an incoming UN team will try to answer. A compromise is not inconceivable, producing a mix of voting methods to pick an assembly. The real work—drafting a constitution that gives the main say to the majority while protecting minorities within (probably) a federal system—will be even harder. That will be done by a constituent assembly elected by universal suffrage early next year, leading in turn to the constitution's endorsement by referendum and to the direct election, finally, of a full-blown government. That seems a long way off today. But it is not unimaginable.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Human rights in Morocco

An Arab first

Jan 22nd 2004 | RABAT
From The Economist print edition

Splendid—if the king's men continue as they have started

THE clemency shown this month to 33 people deemed subversive, some of whom were freed from prison while others were pardoned while out on appeal, may mark a loosening of Morocco's political straitjacket. The happy men include a dozen Islamists, a dozen independence-campaigners from Western Sahara and a clutch of journalists, among them a well-known satirist, Ali Lmrabet, deemed to have insulted King Mohammed. No less important was an announcement last month that a commission had been set up to produce a definitive account of human-rights infractions in Morocco over the past few decades. If this does its job well, it may set an example to the entire Arab world.

Events during the often turbulent reign of King Mohammed's father, Hassan, will keep the commission busiest. He came to the throne in 1961, five years after independence and four years after the monarch's title had been changed from “sultan” to the slightly less autocratic-sounding “king”. By the time he died, in 1999, thousands of Moroccans had probably seen the inside of secret detention centres where interrogators inflicted torture known by such names as “the parrot” and “the aeroplane”, or involving electric shocks or just a urine-soaked rag over the mouth—all in the name of “king and national unity”.

The new commission, appointed by King Mohammed, includes seasoned human-rights campaigners, some of them former political prisoners. If they have their way, their report, due within the year, will be unprecedented in its frankness. Morocco's army, police and security services have apparently agreed to open their archives. Current or retired members will have to give evidence, albeit behind closed doors.

A previous attempt by a royal commission in the twilight years of Hassan's reign to “draw a line under the past” satisfied no one when it acknowledged just 65 deaths in detention. International observers put the true figure at several hundred. Among Moroccans keenest to look at the past are urban intellectuals who once dared to dream of a republic, Berbers in the Atlas mountains drawn into ill-fated rebellions and those seeking independence for Western Sahara.

The latest commission has been told firmly that it cannot name names or pillory individuals yet will have a quasi-judicial role. People guilty of gross abuses and still in official posts will apparently be asked discreetly to resign. That would signal that illegal detention and torture no longer have official blessing, and would go some way to winning over local human-rights groups who fear that the commission may prove toothless.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Arab education

The risks of reform

Jan 22nd 2004 | CAIRO
From The Economist print edition

Governments in several Arab states are edging warily towards enlightenment

IN THE third year of secondary school, Saudi schoolchildren learn that a good way to show love of God is to treat infidels with contempt. They also learn that such “ideologies” as communism, Arab nationalism, secularism and capitalism are all forms of apostasy. Yet none of those things is quite as bad as pretending to be a proper Muslim, then sneaking off to perform rituals in tombs. Anyone who does so forfeits his right to life and property; his womenfolk may be captured and enslaved.

Such peculiar takes on morality have long alarmed liberal-minded Saudis, as well as the 1m-odd Saudis who are Shia Muslims, and so happen to venerate the shrines of sundry saints and martyrs. Outsiders have taken growing offence, too, in the belief that such narrow interpretations of Sunni orthodoxy foster violent attitudes. But only recently, after a wave of deadly attacks by religious extremists inside the kingdom, has the Saudi establishment itself been roused to action.

At a recent summit of the Gulf Co-operation Council, a body that links six oil-rich Arab monarchies, Saudi Arabia's rulers joined in a common pledge to reform religious education across the region. The Shura council, a proto-parliament whose members are appointed by the king, has just passed an education bill that explicitly calls for a new emphasis on moderation in religion classes.

Prince Nayef, the powerful minister of the interior, long denied that Saudi nationals could have been responsible for the September 11th tragedy. His ministry has often silenced liberal voices in the local press. Now, with his police risking their own lives to hunt down militants, he says it is the extremists who need their “heads and minds cleansed of errors”.

His milder-mannered half-brother, Crown Prince Abdullah, has appointed a 70-strong group of worthies, including, unusually for Saudi Arabia, Shias, women and some noted liberals, to debate reform and suggest remedies. At the latest session of this vaunted “national dialogue”, Saudi researchers presented a paper that details how textbooks inculcate values that the authors declare conflict with both the modern age and the spirit of Islam. Scores of examples make for a convincing argument, and education officials have already withdrawn some texts from classrooms. The national dialogue calls for further revision of the curriculum to promote the values of tolerance and moderation.

But purging textbooks of all incitement will be hard. The problem is not simply the sheer volume of material: Saudi high-school students spend as much as a quarter of their time on obligatory religious studies. Across the region, Islamist hardliners are interpreting any whiff of change as part of an American-inspired plot to destroy Islam. A review of Kuwait's religious curriculum has been met by heated protests from Islamist parliamentarians, despite the reviewers' plea that they have yet to find anything objectionable. In Jordan MPs have decried new textbooks that describe suicide attacks on civilians as a form of terrorism. The most recent voice-from-the-cave message from Osama bin Laden specifically damns educational reform as a subtle form of American sabotage.

A vocal reaction

Mr bin Laden is known to enjoy a following among Saudi militants, but the country's rulers nevertheless got a shock from the vitriolic riposte to the national dialogue that came in the form of a petition, signed by 160 academics, clerics and judges. Castigating would-be reformers as “partisans of infidelity, polytheism and delusion”, the petition declares that the “American enemy” will not stop pressing for “reforms” until Muslims declare Jesus a god and Israel the fulfilment of the covenant of Abraham. It concludes by calling on parents and teachers to resist reform, because “defence of our curriculum is a

defence of our existence and identity".

In most Muslim countries, in ordinary times, such language would be dismissed as hot-headed nonsense. The Saudi state, however, is built on an implicit alliance between the ruling family and followers of a puritan version of Islam sometimes called Wahhabism. In the past, the al-Sauds have preferred to placate religious militants, with jobs and control of bodies such as the religious police and the education ministry, rather than risk a rupture.

The current tussle over education coincides with a wave of popular anti-Americanism that boosts the appeal of Islamist xenophobia. For these reasons, backers of educational reform have been careful to stress that change is needed not to placate non-Muslims but to promote cohesion among Muslims themselves. Perhaps, some might add, so as better to resist the perceived onslaught of Americanisation.

Reflecting the delicacy of the Saudi conundrum, Crown Prince Abdullah insisted in a recent televised speech that, though reform was inevitable, he would not tolerate anyone "hurting the Muslim faith in the name of freedom of expression". And while liberal Saudis cheered the keen (and sometimes not completely veiled) participation of Saudi businesswomen at the recent Jeddah Economic Forum, this breech of strict social rules won a searing reproach from the kingdom's top state-appointed religious authority. "Mixing", thundered Sheikh Abdel Aziz Aal al-Sheikh, is the "root of all evil" and the "origin of vice and adultery".

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Angola

The shameless rich and voiceless poor

Jan 22nd 2004 | CAFUNFO, NORTH-EASTERN ANGOLA
From The Economist print edition

Stomach-churning allegations about Angola's rulers

Get article background

There's dirt at the top, too

SOMEONE is profiting from Angola's instability. According to the finance minister, it is Human Rights Watch, a pesky New York-based lobbying group that accused Angola's rulers last week of having filched or misspent $4.2 billion in five years. At a press conference to rebut the allegations, Jose Pedro de Morais protested that the country was “just out of armed conflict”, and that it was unfair for the group to throw mud at such a time.

Since Angola's civil war ended two years ago, the government has run out of excuses. Before the army shot him, politicians could blame the monstrous rebel leader, Jonas Savimbi, for everything. If there was no money for schools and hospitals, that was because it was needed for the war. If the government kept mum about how it spent Angola's huge oil revenues, that was for reasons of national security. If you thought the ruling party, the MPLA, was no more than a bunch of crooks, well, the rebels of Savimbi's UNITA were worse. “The MPLA steals, but UNITA kills,” was the unofficial slogan.

No one accepts these excuses any more. What is more, the Human Rights Watch report suggests they were never valid. Granted, military spending was high during the war, but the sums that seem to have disappeared from the public coffers were 78% as large between 1997 and 2002. The missing cash was equivalent to nearly a tenth of GDP each year—as if an American administration had “lost” $5 trillion—and roughly as much as was spent on all social services. The government blames “insufficiencies” in its accounting system, but with estimated oil proceeds of $17.8 billion over the period in question, they could perhaps have hired more accountants.

Half of Angola's children are malnourished, but there are 20 Angolans worth $100m or more, according to the Economist Intelligence Unit (EIU), a sister company of *The Economist*. Six of the seven richest on the EIU's list were state officials; the other was a recently retired official.

Perhaps unsurprisingly, the government is not keen on transparency. Asked when certain reports on oil revenues might be made public, the central bank's governor told Human Rights Watch that “the reports are public—the government has seen them.” That was in 2001. Since then, the state oil company, Sonangol, has started to publish a bit more useful information about its takings, but only a bit. And despite the end of the war, the government still has the power to classify its “commercial interests” as state secrets, and jail for up to two years anyone who divulges them.

Corruption at the top translates into hardship on the ground. In Cafunfo, for example, a scraggy town in the north-east, the streets are a rapidly eroding mixture of mud, rubbish and sewage, there is no electricity, no running water and no school above the fourth year of primary education. Though Cafunfo sits in the middle of one of the world's richest diamond fields, most people eat nothing but *funge*, a barely-nutritious dough made from cassava roots. The gem trade is largely controlled by army officers (including former UNITA ones), government types and their foreign cronies. A clinic built by the state mining company in 1992 has been commandeered by the police, who demand bribes from anyone who tries to move goods in or out of town. The law cannot help those wronged by the mighty, as only 23 of Angola's 168 municipal courts were functioning (as of July last year), a problem the government says it will fix—by 2051.

To be fair, life in Angola has improved since peace broke out, as the UN noted this week. Most of the 100,000-odd ex-rebels have been disarmed and resettled, thanks to the know-how of the army. The UNITA veterans were promised farming tools and vocational training, which have largely failed to materialise. But they were used to living rough and have started planting crops and building houses on their own.

Meanwhile, UNITA's leaders have become politicians and are looking forward to contesting a general election next year. Smaller opposition parties—ie, those without blood on their hands—want a poll sooner but are ignored. The constitution says the vote should have happened seven years ago but for some time it has been scheduled “in two years' time”. The president since 1979, Jose Eduardo dos Santos, promised two years ago to stand down but seems to have forgotten this pledge. Last month he was re-elected, unopposed, as the MPLA's chairman, which would make it easy for him to assume the party's candidacy, should he so choose.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Uganda's Jews

Equatorial Torah

Jan 22nd 2004 | NABUGOYA
From The Economist print edition

The self-taught Jews of east Africa want recognition

AP

The people who chose to be chosen

STROLL through the foothills of Mount Wanale in central Uganda, and you may be surprised to meet children greeting you with a cheery "*Shalom*." The village of Nabugoya is home to one of the world's least-known Jewish communities, replete with its own brick synagogue, marked in chalk with the Star of David.

Unlike the 18,000-odd remaining Ethiopian Jews, whom Israel recently promised to airlift to Tel Aviv, the Abayudaya of Uganda do not claim a lineage dating back to King David. They converted to Judaism less than a century ago. "It began in 1919," explains Rabbi Gershom Sizomu. A local chief, Semei Kakungule, had—so he says—been promised a kingdom by the British, but they broke their promise, so he took his revenge on British missionaries by rejecting the New Testament for the Old.

At first, Mr Kakungule was forced to improvise, but in 1926 he obtained a Bible in Hebrew and English from two Jewish traders. For the next 35 years, his people studied the scriptures in Hebrew and in complete isolation, before being discovered by Israel's first ambassador to east Africa. By 1961, the Abayudaya had 3,000 members and 30 synagogues.

Then, in 1972, the Ugandan tyrant Idi Amin banned Judaism, after a row with his Israeli arms suppliers. The Abayudaya's synagogues were filled with goats and their prayer books burned. All but 300 of them left the faith. Mr Sizomu, a third-generation Jew, and schooled at a rabbinical college in New York, is trying to rebuild the community. It now has six synagogues and 600 members.

Israel has shown no interest in Mr Sizomu's efforts, but he is not too disappointed. "When I read about the violence in Israel, it puts me off," he says, lounging under a banana-tree on a sunny Sabbath.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

South Africa's war on AIDS

A slow march

Jan 22nd 2004 | PRETORIA
From The Economist print edition

Soldiers get AIDS drugs, civilians wait

Get article background

SOLDIERS jostled camera crews, doctors beamed and the deputy defence minister snipped a red ribbon to open South Africa's first clinic for soldiers with HIV. This ceremony in Pretoria was the first sign of progress in implementing a long-delayed plan, announced in November, to distribute anti-AIDS drugs nationwide.

The army had cause to act early. At least one in five of all soldiers, sailors and airmen is infected. Aspiring recruits who test HIV-positive are now (controversially) turned away, on the ground that they make less effective soldiers. Besides their tendency to fall ill, they are barred from UN peacekeeping operations. They are expensive, too, partly because their families often need treatment. Helpfully, America will provide $30m-35m to the new clinic in Pretoria over five years. This week the first five soldiers registered for a course of anti-retroviral drugs.

As well as treating the troops, the clinic will conduct research on how best to use the available medicine. If that helps speed the national distribution of drugs, it is welcome, say campaigners. But Eric Goemaere of Médecins Sans Frontières, a group that dishes out anti-AIDS drugs in townships near Cape Town, notes “little sense of hurry” in the health ministry. Though the neighbouring Eastern Cape province has asked his group to train nurses in drug distribution, he sees few signs of the national programme starting.

An official at the health ministry counters that staff are “working flat out” on the drug plan; by 2007 state clinics should be treating 1m patients. (Some 5m South Africans are HIV-positive, but most do not need drugs yet.) Maybe, but the ministry has only just started meeting drug firms to discuss bids to supply large volumes of anti-AIDS pills. The drugs cost barely a tenth of what they did four years ago: about $250 per patient a year, including the cost of testing. But tenders must be competitive, a supply and storage system must be set up, and patients must be educated. Nationally, this will take a full year.

The shame associated with AIDS shows no sign of disappearing. Many soldiers shun testing for fear that they will be bullied if an HIV-positive result is known. Treatment that prolongs lives would give them a powerful incentive to get tested, however, and the more people known to be HIV-positive but healthy, the less the stigma, perhaps.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Polish politics

Miller's crossing

Jan 22nd 2004 | WARSAW
From The Economist print edition

Reuters

Poland's prime minister is under pressure at home and abroad

Get article background

THE gods smiled on Leszek Miller, Poland's prime minister, when his helicopter crashed near Warsaw in December. Feeling, he said afterwards, “the touch of angel wings” around him, he survived the impact with minor back injuries, even making a brief appearance in a wheelchair at a European summit in Brussels a few days later. This week he emerged from a month's convalescence, marking the occasion with a reshuffle that included sacking his treasury minister. He pronounced himself a rested and refreshed man. He needs to be, given the challenges facing him.

One recent poll has given Mr Miller's ruling socialist party, the SLD, only 17% support among voters—well behind the leading conservative opposition party, Civic Platform, and behind even a dangerously populist agrarian party, Samoobrona (self-defence). With a general election looming next year, the possibility of another SLD victory now seems far-fetched. The bigger question is whether the party might suffer a defeat so crushing as to finish it as a serious force, or at least to bring drastic changes, including the departure of Mr Miller's generation of ex-communists from its leadership.

The scandals that have tainted the SLD's reputation drag on. This week the head of the party's parliamentary caucus resigned, two months after he was caught up in allegations of influence-peddling. Next week Mr Miller will give evidence in the trial of Lew Rywin, a film producer who allegedly offered to use his political connections to influence the drafting of a media law in ways that would favour a private publishing group, in exchange for a large payment. The court hearing is unlikely to produce new sensations, but it will do little for Mr Miller's image.

The good news is that Poland's economy is picking up. But that comes despite government policies, not because of them. This year's budget, which parliament was due to approve on January 23rd, promises another big deficit—perhaps 5-6% of GDP, after 4.8% last year. Unemployment remains high. Government borrowing will continue to crowd out the private investment that Poland needs to raise growth and catch up with its richer neighbours in the European Union, which it joins in May. Too much is being spent on badly targeted social-security schemes and on poor-quality public services.

EU entry has highlighted the need for fiscal reform, because it requires the Polish government to work towards the adoption of Europe's single currency, the euro. Under the Maastricht criteria, this means running a budget deficit no bigger than 3% of GDP. Mr Miller's economics minister, Jerzy Hausner, has

produced a medium-term plan for belt-tightening that includes bold structural reforms, such as raising the retirement age for women to that for men, and the trimming of automatic indexation of some benefits. The programme is due to be adopted by the government on January 27th, but already it is in danger of being watered down, after opposition from trade unions and others.

The Hausner plan seems well-intentioned economically, but eccentric politically. Savings begin in earnest only next year, when a different government with ideas of its own is likely to be in office. At worst, the plan will be cut to pieces to appease spending constituencies. That could unsettle the financial markets, which have already punished Hungary for a slack fiscal policy by sending its currency, the forint, skidding and its interest rates soaring. The Polish zloty is already under pressure.

A different problem is how to repair relations with France and Germany, which Poland would dearly like to count as allies. Both have criticised Poland, along with Spain, for blocking the draft EU constitution at last month's summit. Poland objects mainly to a proposed new voting system for national governments that would reduce the generous weights promised to Poland and Spain under the Nice treaty of 2000. Mr Miller's tough stance over the constitution won him applause across the political spectrum at home, but he has overdone things by endorsing opposition cat-calls for “Nice or death”. His government does not want to enter the EU at odds with two of its leading countries, and stereotyped as a troublemaker.

Moreover, even while professing impatience with the Poles, the French may be smiling behind their hands. The more the EU is divided by constitutional and other rows, the stronger the French case for a tighter Franco-German alliance that could lead a pioneer group towards closer integration. That would leave newcomers such as Poland out in the cold once again.

Poland's hopes for a rapprochement rest mainly with the Germans, whose enthusiasm both for EU enlargement and for an EU constitution has been more sincere. The Poles hope quietly for a compromise deal that would postpone the decision on a new voting system for another four or five years. That means finding a formula that satisfies Germany and others by making the shift to a new voting system almost inevitable, but which Poland could paint as something less than a surrender. A tall order, even if Germany co-operates.

Whether the constitutional row rolls on or whether it is solved in a way that upsets Polish voters, the result is likely to be a bumpy ride into the EU for Poland in May. Small wonder that Mr Miller long since abandoned talk of calling an early election in June, to coincide with elections to the European Parliament and to profit from the boost that EU entry was once expected to give the Polish national mood.

But that still leaves him facing an election next year, with no prop to his popularity save for hopes of a modest rise in economic growth, from 3.5% last year to perhaps 4.5% this year. If the outcome is a defeat which shatters the SLD, few on the Polish right will consider it much of a loss. The worry is where its alienated voters will turn. If they go to the moderate right or left, well and good. But if they go to Samoobrona and its like, then Poland, and Europe, have some problems ahead.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Turkey

Coming to America

Jan 22nd 2004 | ANKARA
From The Economist print edition

A big agenda for Tayyip Erdogan's trip to the United States

LAST year, when Turkey's parliament refused to let American troops use Turkish soil as a launch-pad to strike Iraq, it seemed that the “strategic partnership” forged over 50 years between Turkey and the United States was in danger of collapse. Then, just as the two allies sought to patch things up, American troops in northern Iraq arrested 11 members of Turkey's special forces on suspicion of planning to assassinate Kurdish officials. Turkey's top general, Hilmi Ozkok, loudly denied this and said the detention of his men for two days in Baghdad marked the “biggest crisis” between the two countries.

AP

Erdogan among the hawks

Tempers on both sides have since cooled. Yet differences over Iraq remain the biggest source of friction between Turkey and America. Iraq is sure to dominate the agenda when Turkey's mildly Islamist prime minister, Tayyip Erdogan, lunches with President George Bush this week, on his first official trip to Washington since taking office last March.

The Turks' biggest concern is over Iraqi Kurds' demands for an autonomous state, including the oil-rich province of Kirkuk. Should the Kurds persist in their claims for an ethnically-based federation, said a Turkish general, Ilker Basbug, last week, the future would be “difficult” and “bloody”. The fear is that American support for Iraqi Kurds might re-ignite separatist passions among Turkey's own long-repressed Kurdish minority.

Last autumn's ding-dong over whether Turkish troops should go to Iraq has not helped. In October Mr Erdogan pushed through parliament a measure authorising the deployment of 10,000 Turkish troops, chalking up useful brownie points in Washington. But by November, the Americans had withdrawn the request for the troops, after Iraqi Kurds had threatened to fight them if they arrived. Coming on top of America's reluctance to move against 5,000 rebels from the Kurdistan Workers' Party (PKK) holed up in Iraq, this deepened the suspicions of Turkey's generals that the Americans favoured the Kurds.

Mr Bush will reassure Mr Erdogan that his government is as committed to dealing with the PKK as it is to preserving a united Iraq. But in private American officials concede that some of Turkey's concerns are legitimate. Turkey has been helping the American occupation by opening bases and airspace to coalition aircraft and personnel. It deserves something in return.

The trouble is that since September 11th America's interests have shifted. During the cold war, Turkey's role was to help contain the Soviet Union. Today, says America's ambassador to Turkey, Eric Edelman, reform in the Muslim world “is America's most important strategic initiative”, in which Turkish success

may play a big role. “The idea of a secular, democratic Turkey moving towards the European Union and led by an Islamist-oriented party”, he says, “would be a huge stench in the nostrils for the likes of al-Qaeda.” (That group claimed responsibility for suicide-bomb attacks against British and Jewish targets in Istanbul in November.)

To fulfil that dream, Mr Bush will urge Mr Erdogan to keep leaning on the stubborn Turkish-Cypriot leader, Rauf Denktash, to resume talks with the Greek-Cypriots to reunite Cyprus on the basis of the UN peace plan. Not only would a deal over Cyprus enhance Turkey's chances of opening membership talks with the EU; it would also give Mr Bush a useful foreign-policy victory to show off at NATO's summit in Istanbul at the end of June.

Mr Erdogan might reply that it is Turkey's hawkish generals, all bitterly opposed to the UN plan, who need convincing—and not just over Cyprus. If Turkey is to evolve into the full-fledged democracy underpinned by moderate Islam that America wants, the generals and other members of Turkey's secular elite must learn to coexist peacefully with millions of openly pious Turks, instead of calling them all Islamic militants. Some such subversives may wonder how it is that the prime minister's wife, Emine, is banned from official functions in Ankara because she wears the Islamic headscarf, and yet can be received by Laura Bush for coffee at the White House.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD EUROPE
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

German tax reform

Systematic chaos

Jan 22nd 2004 | BERLIN
From The Economist print edition

The prospects for tax reform recede, unfortunately

Get article background

EVEN if German academics left their ivory towers, few politicians would notice. Which makes it surprising that Paul Kirchhof, a lawyer at Heidelberg University, has persuaded a group from the two professions that the country's tax system needs radical reform. He did it by drafting 12 pages of legislation that would do away with most tax exemptions and cut the top marginal income-tax rate to 25%.

Alas, this coalition of scholars and statesmen may not get anywhere. On January 18th Angela Merkel, the leader of the opposition Christian Democrats (CDU), said that she did not expect tax reform this year. This was taken as a signal that she was taking the topic off the priority list. A big change is anyway unlikely before the 2006 federal election, if only because there are so many preoccupying local and regional polls before then.

That Germany badly needs tax reform has been recognised for years. What is new is the attention being paid to simplicity, which is popular with voters. Hardly a day passes without a politician demanding that tax returns be made no larger than a “beer mat”, or quoting the claim that Germany produces over two-thirds of the world's academic tax literature.

Germany is hardly the only country to suffer from fiscal complexity. But marginal and average tax rates are high, especially for companies. That matters, as it makes the country a less attractive place in which to invest. Other countries have responded to a similar lack of competitiveness by lowering marginal-tax rates and scrapping tax breaks, broadening the tax base and simplifying the system. But Germany has managed only incremental reforms. These have left a patchwork that, says the German council of economic experts (a group of wise men), “is fast losing any semblance of being a structured, rational system”.

One oft-cited explanation for this is Germany's federal system, which gives the opposition a de facto veto over tax changes. Less well known is the role of the country's Constitutional Court, says Steffen Ganghof, a researcher at the Max Planck Institute for the Study of Societies in Cologne, in a forthcoming book. The court often has the last say in tax policy. It is widely assumed that it would strike down any law openly breaking with one tradition of German taxation: that corporate- and income-tax rates must be about the same. Combined with the *Gewerbesteuer*, a court-protected local trade tax, this has meant that politicians are limited in their ability to respond to tax competition without losing revenue.

The CDU, adds Mr Ganghof, has often proposed bolder tax reforms than other right-wing parties. One recent plan drawn up by Friedrich Merz, a CDU parliamentary leader, would have put Germany ahead of other countries in simplicity. It suggests three tax rates: 12%, 24% and 36%, for incomes above €8,000, €16,000 and €40,000 respectively. Such radicalism does not make for easy compromises. Despite scrapping many tax breaks, Mr Merz's plan would cut revenues by €24 billion in the first year—which the government cannot afford. Anyway, the governing Social Democrats (SPD) dislike low tax rates, because they want progressive taxes to balance high social-security contributions, which tax lower incomes proportionately more than higher ones.

More surprisingly, the Christian Social Union, or CSU, the CDU's sister party in Bavaria, has qualms of its own. It recognises that the CDU's tax ideas do not square with its health-care plans, which would make social-security contributions more regressive. The CSU has come up with a rather less ambitious proposal, which gets rid of some tax breaks and lowers the top rate only from 45% to 39%.

The big question is what will happen after the 2006 election, which the opposition is likely to win. Might it then implement Mr Merz's plans? By early March, the CDU and CSU hope to find a compromise. One option would be to copy Scandinavian countries by bringing in a “dual income tax” that treats labour and capital income differently. While wages can still be taxed progressively, this allows a flat rate for dividends, capital gains and rents. That would mean taxing capital and labour differently, according to how mobile each is. The CDU could, at least partially, test its flat tax; the SPD and CSU would keep their progressive income tax. But would this be legal? No, says Mr Kirchhof, who once sat on the Constitutional Court. Perhaps he should have stayed in his ivory tower.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

French driving

Speed, rules and psychology

Jan 22nd 2004 | PARIS
From The Economist print edition

A revolution: speed cameras cut speed

AT A time of high unemployment and religious tensions, one issue grips the French: speed cameras. According to one poll, they are the top subject of conversation, put there by 82% of respondents. To the indignation of drivers who had so far escaped these devious devices and their fines, some 100 cameras were installed last autumn. A further 900 are coming in the next two years. For people used to speeding with impunity, the shocking thing is that they work.

Last year, for the first time in 30 years, the number of deaths on French roads fell below 6,000—a drop of 21% from 2002. Ministers have fallen over themselves to claim credit. Reducing road deaths was one of Jacques Chirac's election pledges. And with reason: every year, more than twice as many people die on the roads in France as in Britain.

But the efficiency with which these machines have deterred speed-junkies has baffled the French. A critical survival skill in a rule-bound society is to know how to break the rules. The country suffers from what Jean-Louis Debré, president of the National Assembly, calls “legislative inflation”. The yearly statute books have grown in size from 1,020 pages in 1989 to 1,600 in 2002.

In general, the more rules, the more they are broken. No smoking in the office? No dog-poo on the pavement? No double parking? Pouff! Such intrusions into personal liberty are met by a shrug of indifference. The French even have an expression—*faire sauter les PV* (skipping fines)—for getting speeding fines waived by pulling political strings, a practice that automatic fines have stopped. “Violating legislation”, writes Béatrice Houchard in “Road Delinquency”, a new book, “is a national sport.”

Hence the perplexity over the speed cameras. “It's a small revolution”, commented *Le Monde*, noting the “incredible fact” that the French seem to be driving more slowly, even on Paris's ring-road. Rémy Heitz, a road-safety minister, calls the change a “veritable psychological rupture”. A case study in the transformation of a national psyche? Or a simple lesson that zero tolerance works?

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Russia's president

Vlad the webmeister

Jan 22nd 2004 | MOSCOW
From The Economist print edition

A new children's website may bring the president down a notch

AFP

The smile of the tiger

Get article background

"WHO'S more important—the president, or your mum? Your mum, of course." Such is the sage advice to future voters from a new website, (get-to-know-the-president.com). The children's website has been criticised as another part of Vladimir Putin's unstoppable personality cult. But its creator, Grigory Oster, says its purpose is quite the opposite. "It is to change the next generation's attitude to power."

Mr Putin's invincible popularity is self-evident. The latest craze—after portraits, books and chocolate effigies—is toy bunnies that sing the lyrics of a pop song written in 2002, "I want a man like Putin." It so incensed a school head in Yekaterinburg, it is said, that he confiscated several of the bunnies (whether because he found them disrespectful or because he wanted peace and quiet is not clear). As Mr Putin's presidency has progressed, the state has taken over the main television stations, which now devote large chunks of their news time to the president, enhancing his image as the man who makes everything in Russia happen.

That is the impression Mr Oster wants to break. Although one part of the site for "school-age citizens" is a loving exposé-interview with Mr Putin, in which he admits to having been late for school and other such naughtiness, another part answers basic questions about what presidents are for—or good for. "What is the president not to blame for? Cuts on your knees.""Should the president be making sure that all schoolchildren study hard? That's not his business.""Does the president ever take tests? Yes, and sometimes he just gets two out of five."

It also contains a more sombre warning to the next generation, as well as to those makers of television news shows, singing bunnies, chocolate portraits and the like. "If one day you hear, read or see that, from morning to night, people are...admiring [the president], lauding him, saying that he's great and wonderful, irreplaceable and infallible, then know: the president has not done his job, misfortune has struck, and there is no freedom of speech in your country any more." As Russians prepare to re-elect Mr Putin on March 14th, that message could not be more pertinent.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

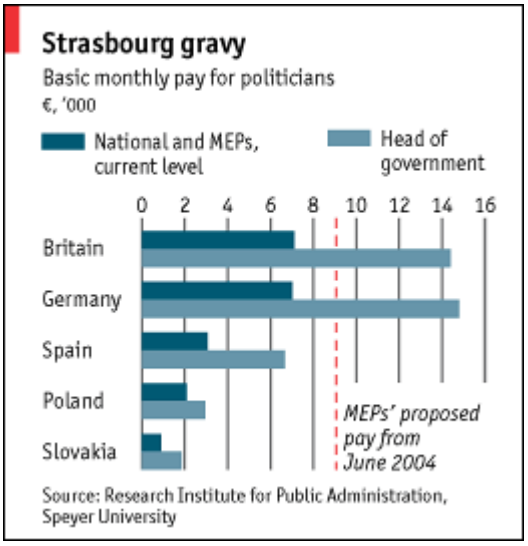
About sponsorship

European Parliament

Banana Union

Jan 22nd 2004 | BRUSSELS
From The Economist print edition

The greed and corruption of MEPs



MEMBERS of the European Parliament routinely fiddle their expenses. This is not a slur or a rumour: it is an acknowledged fact. When flying to and from their constituencies, MEPs are allowed to claim the cost of full-fare tickets, even if they travel on a low-cost airline. This can add many thousands of euros to their salaries.

The good news is that, after years of raking in the cash, the European Parliament proposes to end this scandal. The bad news is that its intended solution is to replace the long-standing system under which MEPs are paid the same salaries as parliamentarians in their home countries.

Instead, the parliament proposes that, after next June's election, all MEPs should get a basic salary of just over €9,000 ($11,000) a month, a number chosen to be equivalent to half the pay of a European Court judge. Such a generous rate will mean that MEPs from the poorer countries about to join the Union will be absurdly well paid compared with politicians back home. A Slovak MEP, for example, will earn around five times as much as his country's prime minister—and nearly 33 times the average Slovakian's income.

The governments of the present 15 members are voting on the pay package next week. They may reject it. The Germans, in particular, prodded by campaigns in the domestic press, want to block the deal. MEPs protest that, if the new pay arrangements are not approved, the best opportunity for years to stamp out the abuse of expenses will be lost. Some add, *sotto voce*, that if MEPs from the new members try to live in Brussels on the same salary as their domestic equivalents, they will be forced either to sleep under a bridge or to fiddle their expenses in the traditional fashion.

Such arguments do not stack up. On top of the basic salary of over €9,000 a month, MEPs will benefit from a special low tax rate, a generous pension scheme, a tax-free allowance of €257 for every day they turn up to work, a further €3,620 a month in general expenses, and over €12,000 a month to pay for secretarial help and office equipment. And—unlike judges—they can take paid outside consultancy work, so long as they declare it.

The threat that, if they are not granted an inflated salary, MEPs will go on claiming fictitious “expenses” is worthy of a banana republic. The abuse of expenses should have been ended years ago and ought to be now, no matter what level of pay MEPs eventually secure. No wonder voters in most countries do not take the European Parliament seriously.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD EUROPE
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Charlemagne

How to blow a trillion euros

Jan 22nd 2004
From The Economist print edition

The start of two years of argument over the European Union budget

ROMANO PRODI, president of the European Commission, may not be the most articulate of men, but he has a wonderful range of facial expressions. Discuss the size of the European Union budget with him, and his face crumples into a picture of exaggerated despair. For if, like Mr Prodi, you harbour a not-so-secret ambition that the commission should one day turn into a genuine European government, the ceiling on its budget of 1.27% of the EU's GDP is pathetically inadequate (and, at present, the budget is well below the ceiling). How can the Union turn itself into a superstate on less than €120 billion ($150 billion) a year?

Even worse, from Mr Prodi's point of view, is the attitude of many EU member governments. Far from boosting the commission's spending power, they are intent on cutting it back. The six biggest net contributors to the budget—Germany, Britain, France, the Netherlands, Sweden and Austria—recently signed a letter demanding a budget of just 1% of GDP. On February 10th the commission will fire back, by issuing its own proposals for the next budgetary period, covering the years 2007 to 2013. It will suggest a budget equivalent to 1.24% of GDP. The difference may sound trifling. But add the seven years together and factor in growth and inflation, and the commission is actually proposing to spend the serious sum of over a trillion euros, some €250 billion more than the tight-wads would like.

It does not help Mr Prodi's argument that so much EU spending goes on projects that are wasteful, counter-productive and—as repeated reports from the Court of Auditors have shown—often fraudulent. The commission is proposing that, even by 2011, over a third of the budget should still go on subsidising farmers. Another third is to be set aside for aid to poorer European regions—subsidies characterised in a recent World Bank report as “ineffective, based on incorrect or at least unsubstantiated economic theory, badly designed, poorly carried out and in most cases a source of wrong incentives”. As much as 6% will go on administration, four times what is earmarked for policies under the heading of “freedom, security and justice”.

If Mr Prodi were ever to commit the mistake of saying what he actually thinks, he would surely admit that these spending priorities are stupid. Indeed, a recent report that he himself commissioned from a group of economic experts, headed by André Sapir, a Belgian academic, says as much. The Sapir report said the EU budget was an “historical relic” because of its emphasis on outdated and irrelevant policies such as farm subsidies, and called for “a major cut in agricultural spending” to finance newer priorities such as education and research.

Great in theory. But Mr Prodi knows that any proposal to cut agricultural subsidies would be dead on arrival, killed instantly by the biggest beneficiaries, notably France. The eminently sensible suggestion in the Sapir report that aid to poorer regions should in future go above all to the eight ex-communist central European countries joining the EU in May will also not be endorsed by the commission. Instead, Michel Barnier, the commissioner for the regions, proposes to split regional aid 50:50 between new and existing members. The argument for this is purely political. The new seven-year budget has to be approved unanimously. The commission knows this means buying off countries and regions that do well out of regional aid today—notably Spain, Greece, eastern Germany and southern Italy.

Mr Barnier's plans for regional aid underline two fundamental truths about the EU's budget-making process. The first is that the fate of the budget ultimately lies in the hands of the 25 governments that do the bargaining. The commission is merely firing the starting-gun for a two-year haggle. The second is that the underlying tension in this budget round will be between the mostly poor new members, which will surely all be net beneficiaries from the budget, and the mostly rich existing members, which will mostly end up losing from it.

The paymaster calls the tune, at last

Even in normal times, EU budget negotiations are formidably tricky. But these are not normal times. Over the past year, the Union has been split by a series of bitter political disputes. There was the row over Iraq, which pitted Britain, Spain, Italy and much of central Europe against an “old Europe” led by France and Germany. Then there was the failure to agree on a new EU constitution last month, when once again Poland and Spain were pitted against France and Germany. The Germans have recently been dropping none-too-subtle hints that the Poles and the Spaniards cannot expect more big cheques from Germany if they keep on blocking the constitution.

The determination in Berlin that EU spending must be restrained has been stiffened by the commission's launch of a lawsuit at the European Court of Justice to force France and Germany to cut their budget deficits so as to comply with the stability and growth pact. The Germans think it is cheeky of the commission to demand painful cuts in domestic spending, while at the same time asking for a rise in the subsidies that they, as the Union's paymasters, transfer to everybody else.

Beyond the disputes over this or that line in the budget proposals lies an unpleasant reality. Several years of lousy economic growth have dented both the confidence and the generosity of the Union's richest countries—especially Germany. Loukas Tsoukalis, author of a recent book on the EU, says that “in the old days you would have solved the constitutional impasse just by writing the Poles a large cheque. But you can't do that any more.” In the old days, there were also bitter fights over the EU budget (remember Margaret Thatcher). But they often had a slightly ritualistic quality and always got settled in the end, usually at three in the morning at a summit of bleary-eyed leaders, with Germany footing much of the bill. Such a happy outcome is no longer guaranteed.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Investigating child murder

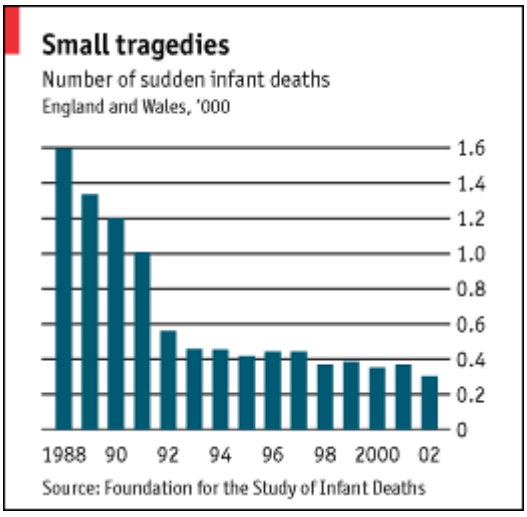
The baby and the bathwater

Jan 22nd 2004
From The Economist print edition

What's behind the cot-death scandal

SIR ROY MEADOW'S reputation as a heroic defender of children took 25 years to build, but only one to demolish. Last January, the Court of Appeal decided that the paediatrician's testimony in the 1999 murder trial of Sally Clark—when he had proffered some clumsy thoughts about the odds of two infant deaths in a single family—was dodgy. Since then, two other criminal prosecutions that relied on Sir Roy's testimony have been overturned. And on January 19th, an entire medical and legal edifice collapsed.

Following another appeal court ruling, the attorney-general, Lord Goldsmith, announced an investigation of 258 cases in which parents were convicted of murdering their children. If it turns out that prosecutors relied heavily on expert testimony of the kind dispensed by Sir Roy, they may be overturned. The upheaval may be even greater in the family courts, where expert advice has contributed to the fragmentation of as many as 5,000 families. In some cases, specialists found evidence of "suspicious" cot deaths in the same family; in others, mothers were thought to be suffering from Munchausen Syndrome by Proxy, a form of child abuse first described by Sir Roy in 1977, and championed by him ever since.



Justice seems to have miscarried on a grand scale. But the reason so many bad decisions were made may have less to do with Sir Roy's ideas about infanticide and Munchausen Syndrome, or even his charismatic testimony, and more to do with a sea change in attitudes to the death of young children. And that has come about because of a very welcome development.

Beginning in the early 1990s, the number of children dying from natural causes began to decline rapidly. Particularly helpful was a 1992 campaign that overturned years of established wisdom on caring for infants. Parents were told to put babies to sleep on their backs and not to smoke around them. This had an immediate impact. The number of cot deaths halved, from more than 1,000 a year to less than 500,

and has since fallen to around 300.

Unfortunately, the fact that fewer babies are dying means greater suspicion is directed at the cases that do crop up. “When infant mortality is high, people don't make a big deal of it,” says Harvey Marcovitch of the Royal College of Paediatricians and Child Health. “These days, though, there's a general feeling that it must be someone's fault.” That sense has been sharpened by the fact that cot deaths now happen mostly to the offspring of young single mothers, heavy smokers and the poor—all commonly viewed as suspect parents to begin with.

British paediatricians are not the only ones to have become more suspicious. As early as 1995, the Canadian government was encouraging investigators in cot death cases to “think dirty”—a slogan later picked up in other countries where infant deaths had fallen. Juries and judges, too, appear to have stiffened. Together with the growing influence of expert witnesses in court, that is part of the reason why some mothers have been jailed on flimsy evidence, and why a great many children have been removed from their parents on flimsier evidence still.

The slide into suspicion might yet be arrested. For several years, the Foundation for the Study of Infant Deaths has been arguing that paediatricians (not the police or social services) should investigate and report on all infant deaths, whether or not they seem suspicious. The idea has caught on in parts of Britain and America, but progress has been slow.

Upping the number of investigations may seem invasive, given the current climate, but it has two advantages. First, the great majority of bereaved parents will benefit from an expert view on why their child died. Second, proper case histories can be collected. Then, if a second child should die mysteriously, police and the courts will have more to go on than vague suspicions and dubious statistics.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The economy

The missing guest at Gordon's party

Jan 22nd 2004
From The Economist print edition

Why productivity growth has slowed in Britain while rising in America

GORDON BROWN, the chancellor of the exchequer, is throwing a star-studded party in London on January 26th. The exciting theme is “advancing enterprise”. Everyone who is anyone, from Bill Gates, founder of Microsoft, to Lord Browne, chief executive of BP, will be there; Alan Greenspan, the world's top central banker, will join in via a video link.

While Mr Brown looks to Europe for ideas on how to create a fairer society he turns to America for tips on how to build a stronger economy. The dream is to enjoy American living standards—a third higher than in Britain—with European social values. Most of that gap in prosperity comes from America's higher productivity. And unlike European countries whose productivity also exceeds Britain's, America's higher labour efficiency has not come at the expense of fewer jobs and hours worked. Since Britain has caught up with European living standards by working harder, the European economic model holds few attractions for the chancellor.

So Mr Brown has borrowed from America—land of competition, enterprise and innovation—in his policies to galvanise the supply side of the economy. He has taken steps to ginger up competition, introducing criminal sanctions for businessmen trying to rig markets through cartels. He has striven to promote enterprise by helping small businesses. And he has sought to encourage more innovation through a tax credit for businesses undertaking research and development.

Some of these policies have been introduced only recently, so they still need time to prove themselves. Even so, nearly seven years after Mr Brown became chancellor, the government's record on productivity is disappointing. Output per worker has risen by 2.1% a year since 1960. But since Labour took office in spring 1997, it has increased by only 1.7% a year; over the last 12 months it rose by 1.5%.

The record is all the more disappointing given the remarkable spurt in American productivity growth. Britain had been slowly catching up with America, but starting in the mid-1990s American productivity growth accelerated as businesses used information and communications technology (ICT) to become more efficient and innovative. And during the recent economic downturn, America's productivity growth continued to speed up, while Britain's slowed still further.

Those inclined to see a glass half-full say that the British slowdown may precede a leap forward. America was ahead of the game in investing in ICT, and the introduction of information technology can initially depress productivity growth since it often means disrupting organisations. But Ben Broadbent, an economist at Goldman Sachs, says: “It's taking an awful long time to come through and the longer it takes the more you have to doubt that it's just around the corner.”

Investment in ICT is in any case already contributing to British productivity growth, unlike in other big European countries. According to Dirk Pilat of the OECD, services that use ICT intensively raised their contribution to overall labour productivity growth from 0.4% a year in the early 1990s to 0.9% a year in the period from 1996 to 2001. However, this was more than offset by a decline in the contribution from

sectors that do not use ICT heavily.

In a report on the British economy published on January 20th, the OECD suggests that a deficiency in skills may be the villain of the piece: almost a quarter of the adult population lacks basic literacy skills, more than double the proportion in Germany. A third of 25-34-year-olds—a much larger share than in any other big rich economy—have few or no formal qualifications beyond compulsory education. Yet Britain's skills gap is longstanding, so it is difficult to see why it should now be depressing productivity growth. If anything, says Mary O'Mahony of the National Institute of Economic and Social Research, education is boosting productivity growth as young workers with more years of education replace older less educated ones.

A more likely culprit is the Labour government itself. Despite Mr Brown's pro-productivity policies, the government has wound business up in more and more red tape. This is a worry because regulations can restrict the changes in working practices needed to reap the full potential of new technology. Digby Jones, director-general of the Confederation of British Industry, complains about an avalanche of new employment regulations and says that in financial services, a vital sector of the economy, “we are fast becoming seriously over-regulated.”

Most important, the government is shifting resources on a large scale into the public sector, yet output has not risen commensurately. In the past year, spending on the public services rose by 10.2% in cash terms but this has bought only a 1.7% increase in output. The government says that the figures are failing to pick up a rise in quality; for example, falling class sizes count as a decline in productivity. But in its report, the OECD finds “limited evidence of improvement in service outcomes beyond the trend already seen in the early 1990s” in both education and health. It advises the government to slow down public spending growth in order to avoid “locking in inefficiencies”.

The durability of the pick-up in American productivity growth still offers hope that Britain may eventually follow suit. But that would be despite rather than because of Mr Brown. The chancellor is part of the problem rather than the solution. Cocktail parties for the business world's A-list won't change that.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The minister for (self-) defence

The hardest word

Jan 22nd 2004
From The Economist print edition

Geoff Hoon misses his chance to go graciously

DUNKIRK rather than D-Day is the best-remembered event of Britain's second world war, a preference that exemplifies the nation's esteem for improvisation and making-do. Likewise, recent rumours about British troops going to war in Iraq without the proper kit aroused as much admiration as anger—that is, until the case of Sergeant Steven Roberts made clear the risks of such slapdashness. The affair has lengthened still further the odds that Geoff Hoon, the defence minister, will manage to cling to his job.

Sergeant Roberts was a tank commander who recorded his concerns about the kit that he had and hadn't been issued in a tape-recorded diary. “It's disheartening,” he lamented, “because we know that we're going to have to go to war without the correct equipment.” He had spent hundreds of pounds of his own money on improving his inventory. A few days into the war, and not long after he was obliged to give his body armour to another soldier deemed to be at greater risk, he was shot and killed. After meeting Mr Hoon on January 19th, Sergeant Roberts's angry widow said the minister ought to “consider his position”. Furiously mincing his words, Mr Hoon said he regretted her husband's death, but hasn't apologised for it.

On the face of it, it may not seem that he needs to. As reports by both the National Audit Office (NAO) and the Ministry of Defence (MOD) itself have spelled out, there were certainly shortages of desert clothes and boots among British troops in Iraq, as well as of spare parts and of equipment for detecting and defending against non-conventional attacks. But many of the reasons for those shortfalls had little to do with Mr Hoon. One such was the hurried build-up, made even more hurried by Tony Blair's desire, until as late as possible, to make it look as if peace might still break out.

But there were also avoidable mistakes. The MOD took its just-in-time procurement policy too far, as it has tacitly admitted. And it should have developed a better system to track its assets after they were despatched. It was this failing that seems to have delayed the distribution of body armour in Iraq. The NAO reported that around 200,000 sets of body-armour plates issued since the Kosovo campaign in 1999 “seem to have disappeared”. Mr Hoon has consistently denied or glossed over these failings: there may, he dismissively conceded to a parliamentary committee in May, “have been the odd soldier who did not like his ready-to-eat meal”.

An internal military inquiry into Sergeant Roberts's death is ongoing. But ongoing inquiries can only protect embattled ministers for so long—as Mr Hoon may well discover next week, when Lord Hutton's report into the death of David Kelly is finally published. A government head will probably have to roll and Mr Hoon's is the likeliest: there have already been signs that his cabinet colleagues are preparing to hang him out to dry. If he is forced out for his part in the Kelly debacle next week, Mr Hoon may reflect that it would have been less ignominious to fall on his sword this week in repentant homage to “our boys”.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

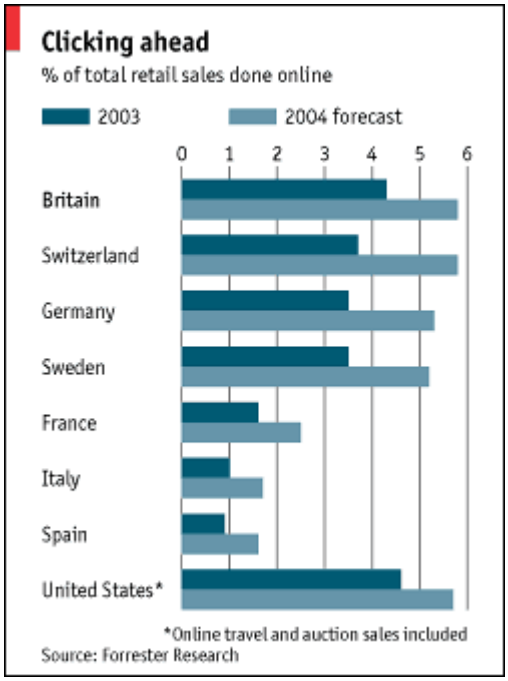
Online retailing

Windows shopping

Jan 22nd 2004
From The Economist print edition

Why online retailing is booming so fast in Britain

Get article background



SIZE for size, Britain has overtaken America as an online retail market. And—though the Swiss are coming up fast—it is ahead of any other west European country: just in front of Germany, but miles ahead of the other big three, Spain, Italy and France. So says Forrester Research, an American-based technology consultancy. “We were amazed when we saw the figures last summer,” says Jaap Favier, at its European headquarters in Amsterdam. “We used to think of Britain as being six months behind America. But no longer.” This year, by his firm's estimates, 5.8% of total British retail sales will happen online, compared with 5.7% of America's; and the American figures, unlike the European ones, include auctions and travel.

Britain's online sales exploded last year, say figures from IMRG, a specialist in e-commerce information: they were 60% up in November-December from those months of 2002. And there is still far to go, though some sectors, and some retailers, will go further and faster than others.

The ideal is a standard item such as an Apple iPod, Agfa SX digital camera or Kylie's “Body Language” CD. Consumers do not need to inspect before they buy: they will get just what they ordered. It costs a fair bit, so a lower price is seriously worth looking for. It is easy to deliver and these days it will indeed turn up.

Goods like these neatly fit the biggest arguments for buying online: price and the convenience of 24/7 shopping. And sure enough, they gave firms like Argos and Amazon a pretty happy Christmas. Food is another matter. It's nice to have the week's groceries delivered—and indeed both Tesco and Sainsbury's pushed up Christmas online sales of it by about 30%—but it doesn't save money. Shoes and clothes (will they fit?) are hard to sell online. So is furniture (“we want to see it and sit on it”), though MFI does good business.

So the boom will be uneven; add in uneven skills—WH Smith's online sales around Christmas were up less than 5%—and in some sectors it will be very uneven. But it will surely happen, now that retailers are learning to sort out delivery problems (a big one for food retailers) and fears about credit-card security, and as customers get reassurance, experience and ever-wider access to the internet.

Yet all this is true in other countries too. Why has Britain leapt ahead? One reason is hefty in-store prices. CDs are notoriously high-priced here. The British recording industry's trade body has been looking sourly at Amazon, while suing Jersey-based Play.com, and CD Wow, from Hong Kong, which sell cheap imports from outside the European Union. On January 21st, CD Wow agreed to stop.

Other reasons lie abroad. Spain and Italy have relatively few personal computers or other internet access, and a more durable tradition of buying from local, non-chain shops. France has that tradition, and for many years it has also had the Minitel: a once-advanced interactive screen system run by France Telecom, which even now supplies a lot of information, though it is less used for actual sales.

None of that applies to the United States, however. Why is its online retailing not roaring ahead, to maintain its previous lead? The very modernity of its traditional retailing may be one reason, suggests Mr Favier. Americans are already accustomed to fiercely competitive pricing and to 24/7 shopping. And they can park easily at the mall. Try that in Oxford Street.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Second-hand Britain

Booting online

Jan 22nd 2004
From The Economist print edition

The car-boot sale has gone into cyberspace

LIKE many entrepreneurs before her, Gail Wall is about to make the big leap and give up her job to run her own business. She has already gone part-time as an accounts clerk. As a single mother, working from home and spending more time with her daughter is important; so too is the chance to make a living doing something she has always enjoyed: trawling through car-boot sales for bargains which might be sold for a profit. What has made her ambition possible is the internet.

The American online-auction company that has done most to boost this business, eBay, reckons that there could be 10,000 people in Britain who make a living, or earn a substantial secondary income, from selling second-hand goods online. Many, like Ms Wall, have turned a hobby into a business. The firm has 8.6m British users buying and selling some 19m items every month. Ms Wall, from Billingham, Cleveland, got hooked four years ago after she bought a plate for £2 at a car-boot sale and sold it online for £120.

The firm is a global phenomenon—last year eBay clocked up $24 billion in worldwide sales—but it has tapped into a particularly British enthusiasm. America may have its yard sales and France its flea markets, but it is the Brits who flock in droves to car-boot sales every weekend, cruise high street charity shops, queue outside village hall jumble sales and are glued to television programmes like “Bargain Hunt”, “Cash in the Attic” and “Bootsale Challenge”, which are mostly about buying and selling tat. “I think it's because British people are shopkeepers at heart,” says Ms Wall. “And everyone loves a bargain.”

Car-boot sales took off in the dreary recession-hit early 1980s as people tried to raise some extra cash. They now attract an army of full-time, part-time and occasional traders, and have evolved into a form of entertainment in their own right. Doc Cox, an ex-presenter of a long-gone TV show called “That's Life”, is one regular. He searches out additions for his collection of old records, and writes a column for www.carbootcalendar.com, a self-proclaimed booters' “bible”, where he records his regrets at leaving the London booting scene to live in the wilds of Suffolk:

> I'll miss the grand-prix start at the Bledlow/Cowleaze Sunday afternoon boots in West Wycombe. It's all very Wild West. First the vans roll in like the Oklahoma land-rush. Half an hour later the early-entry punters thunder in like a herd of buffalo or marauding redskins. That's when you hear startled stallholders shout the classic line “Get them wagons into a circle boys.” All great fun!

EBay has taken this spirit of adventure into cyberspace and produced its own rules of the game. Just as rogue dealers can be banned from boot-sales, dodgy traders are also suspended from eBay. It operates as a self-regulating community in which both buyers and sellers leave “feedback” about each other. This builds into positive or negative points—and points mean reputations are at stake. Even paying is made easy. An eBay subsidiary, PayPal, takes care of online and credit card payments. It too is now setting up a British base.

The eBayers are more eclectic than the boot-sale bunch. They range from teenagers hunting down “vintage” clothing to computer gamers desperate to get their hands on the latest 3-D graphics card. Many are collectors or hobbyists—which Britain has in droves. They often know a thing or two about their particular passion, and their expertise, allied to the internet, can turn a hobby into a business. There is talk of second homes and six-figure incomes from a spare bedroom equipped with a PC, an internet connection and a digital camera. Ms Wall's expertise is ceramics, particularly Royal Doulton. Nine out of ten of her customers live overseas. EBay also offers a separate service which allows serious traders to run a virtual “store”.

EBay's rivals have noticed this potentially lucrative market. Amazon, which also has a British-based website, has started offering second-hand goods, but at fixed prices. In November and December, internet purchases in Britain were worth $2.5 billion, according to IMRG, an e-commerce information group. In terms of visits to “shopping” sites, eBay was far away the most popular, with 26% of the market, followed by Amazon at 8%.

The “serendipity factor”, says Doug McCallum, eBay's British manager, is a big part of the appeal. “You might go looking for a Madonna CD, but then you see an autographed poster which brings back all sorts of memories,” he adds. “Maybe the poster is from a concert you were at.” The ability to get price information about almost anything somewhere online is a further draw. No longer can there be any doubt about what something is worth, whatever it is.

Earlier this month a ship broker tried to sell a decommissioned British aircraft carrier on the American site, but the former HMS Vengeance was withdrawn because it was judged to be an armament, and arms sales are banned. Still, all life can be found on eBay: a huge number of antiques and knick-knacks; Britney Spears concert tickets; a teeth-whitening kit; a job lot of 48 oil-rigger boots (sizes six and 12 only); and an odd sock being flogged by a hard-up student from Hemel Hempstead. He got 6p. Someone from Blackpool got £2,050 for his jet-powered milk float.

Now the murkiest of second-hand markets looks like being turned on its head by internet auctions: used car sales. Last year eBay Motors sold 69,000 vehicles in Britain—which makes it Britain's biggest car-dealership. People apparently hold second-hand car dealers in such low esteem that many prefer to buy online, sight unseen, though some sellers let buyers pop round for a test before placing a bid. Nor are the cars all old bangers. The most popular for sale are BMWs. Many dealers have started using the service.

Internet auctions are also creating entirely new businesses. Here's one to try in Britain: set up a drop-off service where busy people and computer phobes can leave their unwanted items. Then auction them on eBay for a cut of the proceeds. It's a sort of online version of a local auction house, but one with global reach and where the sale room never closes. Not convinced it would work? Randy Adams has set up just such a business in the San Francisco area. His first AuctionDrop store opened in March and by the end of December he had sold $1.6m of goods. He has just collected $6.6m in venture-capital funding to expand his business. Don't all rush together.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD BRITAIN
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Bagehot

A little local difficulty

Jan 22nd 2004
From The Economist print edition

The government wants to replace the council tax with something more imaginative

IT SEEMED a jolly good idea at the time. That could be the epitaph for all well-meaning attempts to reform the funding of local government. And it's one the government should keep to the front of its collective mind as it wrestles with the problem of coming up with something better than council tax.

Nick Raynsford, the local government minister, looks a worried man, and so he should. Council tax, a levy based loosely on house prices, was introduced in 1993 by the government of John Major as a panicky response to the poll tax *intifada* that had done more than anything to propel Margaret Thatcher from office. The hated poll tax (or community charge, as it was formally known) had been invented to replace the hated rates.

Now, its successor has duly become the country's most loathed tax. Since Labour came to power, it has risen by 60%. This year, the average rise in council tax was a record 12.9%. In London, the south-east and many of the shire counties it was much higher. Bills for average homes are now £1,100 ($2,000), but many retired people on fixed incomes living in larger houses pay double that. Last weekend, the signatures of 25,000 pensioners protesting against the tax's perceived unfairness were deposited on Tony Blair's doorstep. Pensioners may not riot, but they do, disproportionately, turn out to vote.

Alarmed by the rising tide of anger, Mr Raynsford and his boss, the deputy prime minister, John Prescott, have conceded that council tax in its present form is “unsustainable”. By the summer, they promise to have completed a “Balance of Funding Review” that will recommend alternatives. A few days ago, the cross-party Local Government Association (LGA) stuck in its oar, calling for a broader mix of locally-based taxes, including some form of local income tax, a relocalisation of business rates and a long shopping list of other revenue-raising proposals from local sales taxes to a share of vehicle excise duty.

It is not difficult to identify what has gone wrong with council tax. It suffers from several major defects, the least of which happens to be the frequently made claim that it is inherently regressive. Many pensioners who are cash poor are, thanks to their houses, asset rich; and wealth is wealth. A more serious objection is that, like its unpopular predecessors, it confronts the taxpayer as a single bill and it crucially lacks what is known in the jargon as the revenue “buoyancy” of taxes, such as VAT and income tax, that rake in more as the economy does better.

By far its most grievous fault, however, is its vulnerability to the so-called “gearing effect”. Because it provides only 25% of the money local government spends (the rest comes from central government in the form of the revenue support grant), a 1% increase in spending over and above what central government has projected requires a 4% increase in council tax. Any discretionary spending by councils thus comes at a high political cost.

To make matters worse, this year, despite an average grant-settlement 7.1% above 2002-03, Mr Raynsford's officials and the Treasury got their sums wrong. Thanks mostly to the demands of central government—mandatory extra spending on services such as schools and police, the chancellor's 1% increase in national insurance contributions and the cost of meeting fussy new regulations—local budgets rose by 9%.

Exacerbating all this was a new funding formula that appeared to be biased in favour of Labour-dominated councils. Nobody really knows whether or not it was politically manipulated: the formula by which the settlement is worked out is so complex and impenetrable that not even the Audit Commission understands it.

Fashion victims

Trying to fix the council tax should be enough for the government to worry about: after all, anything it does is almost certain to create another bunch of furious losers. But it has now been conflated with something else: the fashion—embraced by all parties—for the “new localism”.

Twelve years ago, John Major nearly abolished local government altogether, but these days it is all the rage. In a speech this week, Alan Milburn, a former health secretary who remains a close confidant of the prime minister, offered a clue as to why this might be. He argued that Labour's centrally-driven, target-based approach to improving public services had reached its “high-water mark”. The next stage of the reform agenda required responsiveness to local needs, accountability and innovation, none of which were possible without a revival of localism. Labour's election manifesto should outline a new settlement between local and central government containing “an explicit vision of how services are organised and where responsibility lies”. Mr Milburn and, we can intuit, Mr Blair think that localism can be Labour's overarching theme for the third term.

They certainly need to come up with something, but are they really prepared for the consequences? For it to mean anything, local government must be allowed to raise far more of the money it spends. Mr Milburn cautiously suggests 50-50 as the right split. But that LGA tax wish-list has near-revolutionary implications in Britain.

The trouble is that local government in this country, unlike its counterparts in most of Europe and America, has little recent tradition or inherited legitimacy. And what roots it once had have been systematically poisoned over the last quarter of a century. It would be nice to think the council tax is unpopular with voters because they regret its malign impact on local democracy. But in the real world, it's purely and simply because the government's spending binge has caused it to grow too fast.

The new localism is a big idea all right, but the government has yet to discover whether it is one whose time has come. Still, as they say, full marks for bravery.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Living dangerously

Jan 22nd 2004
From The Economist print edition

For businesses, governments and citizens, misjudging risks can be costly. A guide to better targeting, by John Smutniak (interviewed here)

SINCE September 11th 2001, it has become obvious to all that the world is a risky place. Even before that atrocity, the world had seemed far from safe to many, especially those concerned with business and finance. The end of the dotcom craze and the bursting of the stockmarket bubble had already created huge uncertainty. But those are only the most recent examples of unexpected events that can make a mockery of people's plans.

Today's perception of heightened risk is fostered by more than al-Qaeda. Globalisation, for one, has increased the sense of peril. Natural and man-made disasters, including forest fires, earthquakes, big industrial accidents and various transport calamities, have added to the feeling of being under siege. According to a joint study by Belgium's Centre for Research on the Epidemiology of Disasters and A.T. Kearney, a management consultancy, growing globalisation happened to coincide with an increased frequency of both man-made and natural disasters (see chart 1).

Part of this fear is irrational. After all, earthquakes pay no heed to a rise in free trade. What has changed is that telecommunications and media coverage now ensure that such disasters are reported from ever more far-flung places.

But part of the perception of increased risk is justified. Some technologies are indeed making the world a riskier place, creating new potential hazards such as untried drugs and genetically modified crops, as well as innovations that can scupper the best-laid business plans (such as Napster in the music industry). Blow-ups of markets and firms often reflect risks in the real world. Terrorism, or even rumours of it, can send fortunes sinking. A new epidemic such as SARS can ravage an entire industry (in this instance, world travel).

Despite such perils, for most people in rich countries life has become much safer in a number of important ways. Over the past century their life expectancy has risen by around two-thirds. Workplaces, the wider environment and many diseases have become less hazardous. Democracy has spread. Wars in the rich world have become less likely. Even terrorism has become less of a worry in some places, such as Northern Ireland, Italy and Germany.

So it is not strictly true to say that life has become more risky; instead, some risks have become smaller, others have shifted to different people, and new ones have sprung up to take their place. This survey will review some of these shifts in the burden of risk and explore an extraordinary phenomenon: that when people confront risk, whether they are running governments, businesses or their own affairs, they tend to mismanage it.

Look on the bright side

Risk is different from uncertainty, which is unquantifiable. It is more of an educated gamble based on the odds. Taking such educated punts has become easier, thanks mostly to two factors.

The first is information technology, which has made it easier for people to study many past risks in the hope of learning from them. For example, life-insurance companies have looked back at records of births and deaths to estimate lifespans, create actuarial tables and set insurance premiums. Thanks to computer models, the odds on a freakish storm or earthquake are better known, epidemiologists are more successful at tracking diseases, and even man-made crises such as banking debacles and stockmarket crashes can be catalogued and studied to produce better (though, as we shall see, still far from perfect) forecasts. Such technology is also providing better information on the costs of such mishaps when they do occur.

The second factor that has made it easier to quantify risks is the growing use of markets. Markets are especially good at shifting risks from a party that does not want to bear them to one that does. Insurance, for example, can move the cost of a house burning down from a home owner to the insurance company and its shareholders. A stockmarket listing can shift business risks from a single family to thousands of investors worldwide. Risks, though, are not as easy to trade as bananas or cars. People vary in their view of risk, and of how to value it.

For all the progress in using such tools, perhaps the biggest obstacle to dealing effectively with risk remains human beings' perceptions and misperceptions of it. People tend to get risk wrong in a variety of ways, often consistently. A growing awareness of this has been revolutionising economics. It has also been changing the way corporations, governments and citizens deal with the risks they face. This survey will argue that the largest gains will arise from coming to terms with this softer side of risk.

More and more of the world's risks these days are taken on in financial markets. Stockmarkets, which on one view are simply an estimate of the future rewards of all firms discounted by their risks, have become more volatile in recent years. This is partly because technology has made financial markets more efficient, which makes them swing more quickly as the economic outlook changes.

But not all of the volatility in the markets is a response to real changes in fortune. In their eagerness to minimise the risks of financial markets, investors sometimes exacerbate their wobbles. The sheer sophistication of the instruments to manage the risks of market moves may, paradoxically, have made them riskier. Perhaps the biggest risk of all remains a very human emotion: panic, which can cause markets to seize up completely because they are insufficiently liquid, as nearly happened during the LTCM hedge-fund debacle in 1998.

Those wobbles in financial markets have led to a boom in derivatives (meaning financial contracts—such as futures, options and swaps—derived from the prices of other securities). The chairman of America's Federal Reserve, Alan Greenspan, thinks that this kind of financial innovation is good for the global economy. It makes the financial system more flexible, increases the potential rate of economic growth and allows banks and businesses to control the level of risk they take.

Hidden hazards

Yet many disagree. Last year, Warren Buffett, America's most famous investor, called them “financial weapons of mass destruction”. Certainly the new market for credit derivatives, in effect a type of insurance against bond defaults, is causing worries. And America's Freddie Mac, a quasi-governmental mortgage underwriter, had to restate billions of dollars in profits because of improper valuations of its massive derivatives portfolio. Around 90% of the world's 500 biggest companies now use derivatives, according to a poll last year. This survey will argue that some of the worries over derivatives stem not from any inherent evil, but from their power to disguise the intentions of their users.

Companies used to concentrate on the more easily spotted risks, such as financial ones. Now, just as bosses have learned to use sophisticated tools to manage financial risks, they are facing a whole array of new hazards. Increased scrutiny of corporate governance after the scandals in America and Europe has complicated their life. Increased regulation makes managing a company a minefield. Globalisation has intensified competition. Instant communications and heightened media interest mean that a company's reputation can be quickly and easily tarnished.

Governments have the most to learn about risk. Without a better grasp of the costs and benefits of the rules they create to control it, they can do more harm than good. In most rich countries they are still expected to take on risks when markets fail. Yet they have been making bad choices: banning some activities that carry low risks and potentially high benefits, and encouraging others that are highly risky without offering much return.

One of the trickiest problems in dealing with an uncertain future is people's seemingly irrational response to it. But advances in psychology have given us a much better understanding of the way people behave in the face of risk. The results are striking, as the next article will explain.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Freud, finance and folly

Jan 22nd 2004
From The Economist print edition

Human intuition is a bad guide to handling risk

PEOPLE make barmy decisions about the future. The evidence is all around, from their investments in the stockmarkets to the way their run their businesses. In fact, people are consistently bad at dealing with uncertainty, underestimating some kinds of risk and overestimating others. Surely there must be a better way than using intuition?

In the 1950s and 60s, a group of researchers at American universities set out to find a more scientific method. They created a discipline called “decision science” which aimed to take the human element out of risk analysis. It would offer a way of making soundly based decisions for a future fraught with uncertainties. This would involve using computer models for forecasting, estimating the probabilities of possible outcomes and determining the best course of action, thus avoiding the various biases that humans brought to decision-making. Such models, the researchers thought, would provide rational answers to questions such as whether to build a factory, how to combat disease and how to manage investments.

Business schools soon adopted their teachings, and even some policymakers were persuaded. Decision science's heyday may have been the Vietnam war when Robert McNamara, then America's defence secretary, used such techniques to forecast the outcome of the conflict (though, as it turned out, without much success). But mostly the approach did not quite catch on. Decision-makers, whether in business or politics, were loth to hand over their power to a computer. They preferred to go with their gut instincts.

Think like a machine

Daniel Kahneman, now a professor at Princeton, noticed as a young research psychologist in the 1960s that the logic of decision science was hard for people to accept. That launched him on a career to show just how irrationally people behave in practice. When Mr Kahneman and his colleagues first started work, the idea of applying psychological insights to economics and business decisions was considered quirky. But in the past decade the fields of behavioural finance and behavioural economics have blossomed, and in 2002 Mr Kahneman shared a Nobel prize in economics for his work.

Today he is in demand by organisations such as McKinsey and PartnerRe, and by Wall Street traders. But, he says, there are plenty of others that still show little interest in understanding the roots of their poor decisions. The lesson from the analyst's couch is that, far from being random, these mistakes are systematic and predictable:

- **Over-optimism**. Ask most people about the future, and they will see too much blue sky ahead, even if

past experience suggests otherwise. Surveys have shown that people's forecasts of future stockmarket movements are far more optimistic than past long-term returns would justify. The same goes for their hopes of ever-rising prices for their homes or doing well in games of chance. In a recent study of Dutch game-show contestants, people's estimates of their odds on winning were around 25% too high. Americans are perhaps the most optimistic: according to one poll, around 40% of them think they will end up among the top 1% of earners.

Such optimism can be useful for managers or football players, and sometimes turns into a self-fulfilling prophecy. But most of the time it results in wasted effort and dashed hopes. Mr Kahneman's work points to three types of over-confidence. First, people tend to exaggerate their own skill and prowess; in polls, far fewer than half the respondents admit to having below-average skills in, say, love-making or driving. Second, they overestimate the amount of control they have over the future, forgetting about luck and chalking up success solely to skill. And third, in competitive pursuits such as betting on shares, they forget that they have to judge their skills against those of the competition.

•**The anchor effect**. First encounters tend to be decisive not only in judging the character of a new acquaintance but also in negotiations over money. Once a figure has been mentioned, it takes a strange hold over the human mind. The asking price quoted in a house sale, for example, tends to become accepted by all parties as the “anchor” around which negotiations take place, according to one study of property brokers. Much the same goes for salary negotiations or mergers and acquisitions. If nobody has much information to go on, a figure can provide comfort—even though it may lead to a terrible mistake.

•**Stubbornness**. No one likes to abandon a cherished belief, and the earlier a decision has been taken, the harder it is to give up. In one classic experiment, two groups of students were shown slides of an object, say a fire hydrant or a pair of spectacles. The slides started out of focus and were gradually made clearer until the students could identify the object. Those who started with a very blurry image tried to decide early and then found it difficult to identify it correctly until quite late in the process, whereas those who started less out of focus kept a more open mind and cottoned on more quickly.

The same sort of thing happens in boardrooms or in politics. Drug companies must decide early to cancel a failing research project to avoid wasting money, but find it difficult to admit they have made a mistake. Bosses who have hired unproductive employees are reluctant to fire them. Mr Kahneman cites the example of Israel's failure to spot growing threats in the lead-up to its 1973 war with its Arab neighbours. Part of the explanation was that the same people who had been watching the change in political climate had to decide on Israel's response. Similar problems have arisen in recent counter-terrorism work in America. In both cases, analysts may have become wedded early to a single explanation that coloured their perception. A fresh eye always helps.

•**Getting too close**. People put a lot of emphasis on things they have seen and experienced themselves, which may not be the best guide to decision-making. For example, many companies took action to guard against the risk of terrorist attack only after September 11th, even though it was present long before then. Or somebody may buy an overvalued share because a relative has made thousands on it, only to get his fingers burned.

In finance, too much emphasis on information close at hand helps to explain the so-called “home bias”, a tendency by most investors to invest only within the country they live in. Even though they know that diversification is good for their portfolio, a large majority of both Americans and Europeans invest far too heavily in the shares of their home countries. They would be much better off spreading their risks more widely.

•**Winning and losing**. Fear of failure is a strong human characteristic, which may be why people are much more concerned about losses than about gains. Consider the following bet: with the flip of a coin, you could win $1,500 if the coin turns up heads, or lose $1,000 on the tails. Now describe it in another way: with heads, you keep all the money you had before the bet, plus $1,500; with tails, you also keep everything, except $1,000. The two bets are identical, and each one, on average, will make you richer by $250 (although that average will be little consolation to the punter who has just lost $1,000). Even so, people will usually prefer the second bet.

Behavioural economists say that is because the prospect of losses seems far more daunting in isolation, rather than in the context of looking at your entire wealth, even if the average outcome is the same. This sort of myopia in the face of losses explains much of the irrationality people display in the stockmarket.

•**Misplaced priorities**. More information is helpful in making any decision but, says Mr Kahneman,

people spend proportionally too much time on small decisions and not enough on big ones. They need to adjust the balance. During the boom years, some companies put as much effort into planning their Christmas party as into considering strategic mergers.

•**Counterproductive regret**. Crying over spilled milk is not just a waste of time; it also often colours people's perceptions of the future. Some stockmarket investors trade far too frequently because they are chasing the returns on shares they wish they had bought earlier.

Mr Kahneman reckons that some types of businesses are much better than others at dealing with risk. Pharmaceutical companies, which are accustomed to many failures and a few big successes in their drug-discovery programmes, are fairly rational about their risk-taking. But banks, he says, have a long way to go. They may take big risks on a few huge loans, but are extremely cautious about their much more numerous loans to small businesses, many of which may be less risky than the big ones.

But at least when businesses try to assess their risks, they have to worry only about making money. Governments, on the other hand, face a whole range of sometimes conflicting political pressures. This makes them even more likely to take irrational decisions.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

The price of prudence

Jan 22nd 2004
From The Economist print edition

Governments must protect their citizens, but not at any cost

HIGHLY visible threats to life and limb, such as terrorism, health scares and calamities, are especially likely to provoke wild misjudgments about the odds of a peril, and about its likely consequence. When that happens, people tend to turn to their governments for reassurance. Over the past 20 years, the number of government regulations aimed at improving safety in both Europe and America has soared. Up to a point, that makes sense: the richer a country gets, the more its citizens care about health and well-being, and the more anxious they become to avoid putting them at risk.

Tastes in risk vary across countries. Europe is considered fairly risk-averse, and has recently been fretting about greenhouse gases and genetically modified food. But even within Europe, says Ragnar Lofstedt, of the King's Centre for Risk Management in London, attitudes vary widely. Swedes are concerned about dangerous chemicals, and Danes worry a lot about Sweden's nuclear power stations. Italians, although addicted to their mobile phones, are bothered about radiation.

America, on the other hand, is often seen as having a strong risk-taking culture, despite the draconian measures it has taken to snuff out smoking. Americans have generally preferred to sue when faced with the effects of risk, rather than wait for lawmakers to deal with their concerns. Their litigious society has turned to product liability to shift the burden of failed products, such as car tyres or silicone breast implants. The old rule of “buyer beware” has been sidelined.

That has led to some landmark court decisions in recent years. In 1994 McDonald's was required to pay $3m (later reduced) to settle a lawsuit after a customer spilled a cup of its scalding-hot coffee on her lap. The court said the company was responsible for telling its customers about the damage its product might cause. McDonald's had to issue a printed warning on its coffee cups, telling its customers that the coffee they “are about to enjoy” is “extremely hot.” And now the firm is being sued for allegedly making people fat.

One American author, Philip Howard, has called this sort of thing “the death of common sense”. There are plenty of other examples. Playgrounds have to do without seesaws for fear of lawsuits if someone gets hurt. A few years ago the American government launched an investigation into “runaway car syndrome” after reports of cars spontaneously launching themselves, yet later it turned out the drivers were to blame. The risks in medicine are also high, so doctors order batteries of tests to protect themselves, driving up health-care costs.

Macabre maths

But common sense gets you only so far when dealing with risks to safety, security and health. How far, for instance, should a government go to save lives by reducing everyday hazards? Life is priceless, of course, especially when it is yours or a loved one's. Yet governments have budgets and must try to weigh costs and benefits. If a life can be saved for a few thousand dollars, that sounds like money well spent. But what if the cost is $100m?

According to Kip Viscusi of the Harvard Law School, the price that Americans put on a life is around $7m. He has researched what people are willing to pay to reduce the risk of death at their place of work and how much money they will accept to compensate them for an increased risk of dying on the job. By cross-analysing data from many surveys, he says, it is possible to discover the value people put on avoiding the loss of a life. Different countries, it seems, have different preferences (see chart 2). The Japanese,

perhaps true to their reputation of being risk-averse, put a price of almost $10m on each life, whereas the Taiwanese seem to be satisfied with a modest $600,000. In general, as countries get richer the price of a life goes up: by 5-6% for every 10% rise in income per head, according to Mr Viscusi.

A country's rule book should reflect its people's preferences, but John Morrall, an official at America's Office of Management and Budget, noted 20 years ago that many regulations fail a basic cost-benefit test. He has just updated his analysis by looking at 76 American regulations for the period from 1960-2001, and has found that government is still doing a poor job. Only just over half the regulations he studied were "cost-effective" as defined by saving a life at the cost of less than $7m, and some were vastly more expensive. In itself, that may not be a bad thing: people may well decide to spend a lot more to protect themselves from particularly nasty deaths, and less to prevent deaths that result from voluntary risk-taking. The problem comes when inefficient regulation is promoted at the expense of the thriftier sort.

According to Mr Morrall, environmental regulations, such as restrictions on hazardous waste and other kinds of pollution, generally cost over $1 billion for every life saved, often much more (see table 3). The cost of such regulations, many of them designed to reduce the use of substances that cause cancer, is far higher than the results seem to justify.

Dear lives 3

Selected US risk regulations

Regulation (year issued)	Cost per life saved, $m*
Child-proof lighters (1993)	0.1
Respiratory protection (1998)	0.1
Logging safety rules (1998)	0.1
Electrical safety rules (1990)	0.1
Steering-column standards (1967)	0.2
Hazardous-waste disposal (1998)	1,100
Hazardous-waste disposal (1994)	2,600
Drinking-water quality (1992)	19,000
Formaldehyde exposure (1987)	78,000
Landfill restrictions (1991)	100,000

Source: John Morrall, Office of Management and Budget *In 2002 $

On the other hand, fairly cheap measures can produce big benefits. In America, simple precautions, such as requiring cigarette lighters to be child-proof or reflectors to be installed on heavy lorries, have proved especially cost-effective. Disappointingly, many measures that could save lives at low cost are still waiting to be introduced. These include reducing some types of fats, such as trans fatty acids, in foods (each life saved would cost only $3,000), or installing defibrillators in workplaces to treat cardiac arrests.

Other countries are not necessarily any better than America at balancing costs and benefits. The British government, faced with public outrage after a string of fatal train crashes, decided to put a lot of money into improving rail safety, but seems to have overreacted. By one measure, it will spend over £2 billion for each life saved.

Governments often spend huge amounts of money on some risks and ignore others that cause far more lives to be lost, usually in response to popular pressure to deal with things such as nasty chemicals. But according to Paul Slovic of the University of Oregon, voters do not necessarily take a rational view. Instead, they are influenced by dread and uncertainty. The more dreadful or unexpected a death, say in a hijack or from a rare disease such as BSE, the more people seem prepared to pay to avert it.

That leads to a problem: most people consistently worry too much about things such as perishing in a nuclear accident or being infected with anthrax after a terrorist attack, which have a low probability of occurring but would result in particularly horrible deaths, and neglect hazards closer to home, such as car accidents, mishaps in the home or health problems arising from eating the wrong things.

Protect or sue?

A transatlantic divide now seems to be opening up in the way that governments guard against such

dangers. American regulators have recently been taking more of a cost-benefit approach to risk, whereas Europeans are putting more emphasis on precautions, whatever the cost. John Graham, appointed as America's top regulator at the Office of Management and Budget in 2001, had previously been an academic who used cost-benefit methodologies to analyse risks. He recently caused a stir by calling the inefficiencies of regulation “statistical murder”, arguing that bad regulation absorbs money that could be better spent to save lives another way.

Europe seems to be going the other way. The approach now favoured is called the “precautionary principle”, which can be summed up as “better safe than sorry.” This was conceived in Germany in the late 1960s as part of the country's new environmental-protection laws, and the idea was that reasonable precautions should be taken when releasing substances into the environment. But it has grown into something far more powerful. Some see it as reversing the burden of proof on businesses that want to launch a product, use a chemical or adopt a new practice. They will have to show that their product is safe in all circumstances, even if the science to prove it is not yet available.

The European Commission has now adopted the same approach. For example, it has recently proposed increased regulation for the European chemical industry, through a programme called REACH, which would require thousands of chemicals to be tested to ensure that they do not cause cancer and other ailments. The proposal has caused a rift between advocates of greenery, such as Sweden, and countries with large chemical industries, such as France, Germany and Britain, which think that the cost of such regulation may far exceed the benefits.

Environmental risks are not the only sort that that cause rationality to be put to one side. Arguably, America's war on terrorism falls into the same category. The terrorist attacks of September 11th 2001 killed 3,000 people. As Mr Viscusi points out, more Americans are killed in car accidents every month, and more than 300,000 die from the effects of cigarette smoking every year; yet Americans are willing to incur huge costs to prevent similar attacks.

Some of the costs of prevention are non-financial, such as having to put up with longer security queues at airports, or accepting more scrutiny from the state. Americans seem prepared to live with these: when Mr Viscusi, with Richard Zeckhauser, studied people's response to the attacks, he found them willing to give up some civil liberties to improve security. But some of the costs can be measured in money: this year the Department of Homeland Security's budget for preventing terrorism is nearly $30 billion. No one knows how many lives that might save.

Terrorism is precisely the sort of uncertainty that is likely to lead to too many precautions: better to be seen to be taking action straight away than to weigh up the costs and benefits first. American airports do seem more secure than they were before the September 11th attacks, but that may not mean Americans are any safer: it may simply persuade the terrorists to look for easier targets.

The biggest question governments face in managing risk is how far they should go. Politicians like to think that they can make life for citizens pretty well risk-free. There are indeed cost-effective—as well as expensive—ways of significantly reducing many risks. But bringing them down close to zero, in government or in any other sphere, will remain a fool's errand.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Too clever by half

Jan 22nd 2004
From The Economist print edition

Tools developed to make financial markets less volatile can have the opposite effect

MARKETS, even more than governments, have been bearing growing amounts of risk in recent years. At the same time, many markets, those for shares as well as for debt and commodities, have become more volatile across the world. Much effort has gone into trying to avoid the ill effects of that volatility. The Basel Committee on Banking Supervision has been working to help banks reduce their risk of failure since the 1970s. Stockmarket investors have learned to diversify. Financial institutions of all sorts have tried to create safeguards against tempestuous market forces.

Much of this effort has been successful. The most recent recession, for example, passed without any large-scale bank failures, in contrast to earlier downturns that typically brought banking crises and collapses of financial firms. Yet it would be premature to think that market risk has been conquered altogether.

The seeds for the current financial volatility were sown in 1973. Before then, the world's currencies were pegged in value, according to an agreement reached at Bretton Woods, the New Hampshire mountain retreat where the post-war economic order was born. Capital flows between rich economies were restricted. Gold, that ancient store of value, still anchored the dollar, at $35 an ounce.

Then America decided to remove the fixed peg from its dollar, which meant that currencies became more subject to market whims. Not coincidentally, other prices became more volatile at around the same time. Oil prices rocketed, helping to make the 1970s a decade of high inflation, and many rich countries put up their interest rates in an effort to tame it. The stockmarkets, of course, had always been volatile. What was new was that other prices started to yo-yo too.

Just as Bretton Woods was collapsing, the discipline of mathematical finance was reaching maturity. American academic economists had managed to reduce markets' animal spirits to just two numbers. The first was the mean, or average, return on any asset. The second was the asset's variance, or volatility, a measure of the size and speed of price changes. For example, a share whose price moves up or down by an average of 2% each day is twice as volatile as a share whose price tends to move by 1% per day.

The wisdom of a quantitative approach appeared to be confirmed in 1973 when two professors working in America, Myron Scholes and Fischer Black, published a paper in the *Journal of Political Economy* which argued that the price of an option (a particular kind of financial instrument, of which more later) could be calculated almost perfectly using a mathematical equation. The formula was based on volatility. The key to the financial kingdom had been reduced to one figure.

For investors, volatility has become synonymous with risk. The wider the swings in the price of a share, the riskier it is reckoned to be. That may seem odd, because it is not the size of the swings that matter to a punter, but where the price of his share ends up. Even so, volatility is often a signal of a real change in risk. When global stockmarkets fell by around 15% in the days after September 11th, they probably

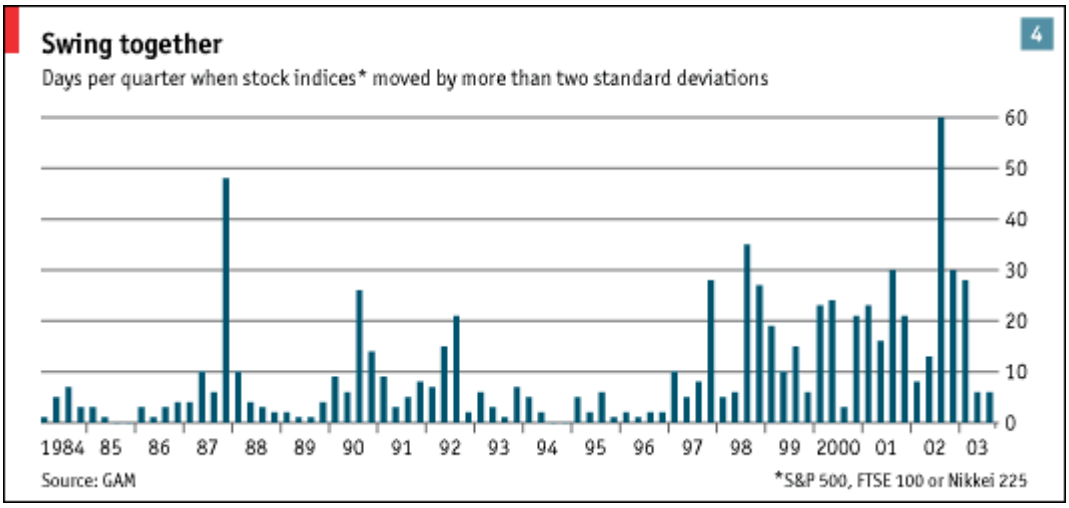
reflected real concerns about the effects of terrorism. A drop in global trade and increased spending on security and defence could reduce companies' profits.

Out of the blue

But not all market swings depend on such news. Another year, 1987, marks an earlier milestone for volatility. Markets fell by 10-20% in a single day when nothing much seemed to be happening in the world. That meltdown posed a problem for financial economists, as well as for investors who sold that day and lost a packet. Financial markets are meant to be aggregators of financial information. If markets are efficient (meaning that they reflect a collective best guess about future profits), price changes should reflect real events.

The 1987 crash inflicted serious damage on this theory. All the attempts to explain the debacle—and there have been many— have failed to come up with a satisfactory answer. Much of the blame was put on portfolio insurance, in which investors program their computers to buy and sell according to rules laid down beforehand, creating the risk of a herd-like reaction when the market turns. What probably happened was that a comparatively modest fall in shares prompted a number of investors to sell, driving prices yet lower. This triggered the computer programs to sell even more shares in an effort to minimise investors' exposure to falling prices. A downward spiral ensued, leaving everyone poorer on paper.

Although nothing on that scale has happened since, there have been increasingly frequent smaller market tumbles. The past five years have been much more volatile than the previous two decades, and volatility has become more global. Avinash Persaud of GAM, a London-based fund manager, has found that storms which send at least one of the three big stockmarkets reeling have become much more common (see chart 4).



Some of this is only to be expected. In an economic downturn, forecasts both for broad economic trends and for profits generally diverge more widely than in good times. Technological change may also have increased volatility. The same goes for increased trading by hedge funds, which can take short positions (betting on a fall in shares rather than a rise)—although the greater liquidity they offer may actually help to stabilise markets.

Now the finger is pointing at the attempts by banks and investors to reduce their own risk of market exposures. That is ironic, because they adopted these risk-management techniques expressly to protect themselves against the whims of the stockmarkets. The technique that has become near-ubiquitous over the past decade is called value at risk (VAR). It started as a project by J.P. Morgan in the early 1990s to help its clients summarise their risks in a single number. Today it has become part of the institutional rule-book. It will be enshrined in Basel II, the proposed new international system of capital-adequacy rules, as part of banks' risk-management requirements.

VARy risky

A typical VAR model will put a figure on your chances of losing no more than a certain amount of money

over a certain period of time. Before VAR was widely introduced, many traders or banks' boards would have found it hard to quantify the risk they were taking. They might have had a broad idea of the circumstances in which they could lose a bundle, but they would not have known how likely this was to happen. After a series of losses in the early 1990s, banks widely adopted the model.

VAR is firmly based on the tradition of quantitative finance. That may offer the comfort of mathematical authority in an uncertain world, but its foundations are shaky in several ways. First, it assumes that market returns conform with a particular pattern. That is what allows risk managers at big banks to express “99% confidence” in a certain outcome. But although economists hate to admit it, the patterns of financial markets are nowhere near as certain as those of, say, physics. The second problem is the possibility of “fat tails” in those statistical patterns. This is the risk that a 1% chance of losing more than a certain amount suddenly becomes a 5% chance.

A third problem is the way that VAR models view the relationship between different kinds of assets. If shares in, say, Argentina and Japan have been moving in step for the past five years, a VAR model will assume that they will continue to do so. But such relationships, known as “co-variances”, are far from stable: markets are as likely to defy history as to repeat it. VAR models take insufficient account of this.

When a nasty surprise such as the LTCM crisis in 1998 comes along, it gets labelled as a “100-year storm”, suggesting that such events are very rare. In real life, though, financial debacles seem to happen much more frequently than once a century. Emerging markets collapse every so often, and prices for debt or commodities regularly break new records. By now, banks should have realised that their models are far too optimistic.

Perhaps the biggest problem of all is the illusion of certainty that VAR creates. Even when the models are accurate, a 99% chance of not losing a bundle also means a 1% chance of losing a fortune, so on two days in every year the VAR loss-limits are likely to be exceeded.

Mr Persaud thinks that VAR models have massively increased the volatility of financial markets by forcing all investors to buy almost identical portfolios. The same VAR models then tell them all to sell at the same time. In doing so, the investors change the pattern of returns that had made the portfolio so attractive in the first place. There are echoes here of the herd instincts let loose by the program trading of 1987, or the dotcom mania of the recent equity bubble.

Mr Persaud points to another source of folly: chasing cross-country correlations in equity markets. In the mid-1990s, investors piled into Asian investments because recent returns there had been high and, more importantly, uncorrelated with other markets. This made them especially attractive to global portfolio investors. But this allure was fleeting. By 1998, the Asian crisis had changed these patterns and investors got burned. In developing countries, Mr Persaud says, the cost of volatility is a big obstacle to foreign investment.

“Extreme value analysis” is a new buzzword for trying to think of all the ways the markets might depart from past form. But as long as VAR models remain the basis for decisions about market risk, market wobbles will continue to catch punters out.

VAR and other quantitative risk models seem to have failed to eliminate dangerous gyrations in banks' profit-and-loss accounts. Kevin Buehler, head of the financial-institutions practice at McKinsey, who has analysed the performance of more than 200 American banks between 1997 and 2002, found that big upsets (defined as bankruptcy, a ratings downgrade of two or more notches or a drop in profits of 20% or more) were far more common than the term “100-year storm” would lead you to expect. His study came up with around 150 such upsets at 90 of the banks in his study. Few of them were big enough to make newspaper headlines, but they caused lots of managers to lose their jobs.

Even so, many investors find the “quant” models reassuring. Banks keep their fingers crossed that as long as their systems are approved by regulators, all will be well. These days they worry more about something that VAR models find it hard to deal with: derivatives.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Financial WMD?

Jan 22nd 2004
From The Economist print edition

Derivatives can reduce many risks, except the human kind

IN MANY people's minds, derivatives—those obscure financial contracts peddled by the maths wizards of Wall Street and the City of London—have become synonymous with financial risk. That seems odd when you consider that they are designed to shift risk precisely from one party to another. In theory, that should help to make investors safer from financial storms.

Derivatives hit the headlines in the 1990s when Orange County, an upmarket suburb of Los Angeles, went bust because it had used them inappropriately. Procter & Gamble, a staid maker of household goods, and Gibson Greetings, a mid-western greetings-card maker, also lost heavily on derivatives. And those were only the biggest debacles.

The use of derivatives by governments, in particular, carries risks that have received too little attention, says Benn Steil of America's Council on Foreign Relations. Governments have employed these instruments mainly to tap cheap capital, but it all depends on how they set about it. Sweden is known as an active and sensible user of such programmes. The Italian government, on the other hand, has recently been criticised for its highly creative use of an interest-rate swap. According to a report for the International Securities Market Association (ISMA) by Gustavo Piga, the government seems to have used derivatives to mask the size of its debt.

Last year, Warren Buffett, America's most famous investor, launched a new tirade against derivatives, calling them “financial weapons of mass destruction.” He was joined by Bill Gross, the manager of PIMCO, a multi-billion-dollar bond fund. They and other critics charge that derivatives contracts contain dormant losses that will come to haunt their owners, typically insurance companies and banks. The critics also claim that derivatives enable corporate treasurers to gamble with shareholders' money.

There is something in this. Only last summer, Freddie Mac, America's giant government-chartered and shareholder-owned mortgage firm, announced that it was restating its profits for the past few years. The culprit turned out to be the derivatives the firm had used, ostensibly to smooth the effects of see-sawing interest rates on its mortgage business.

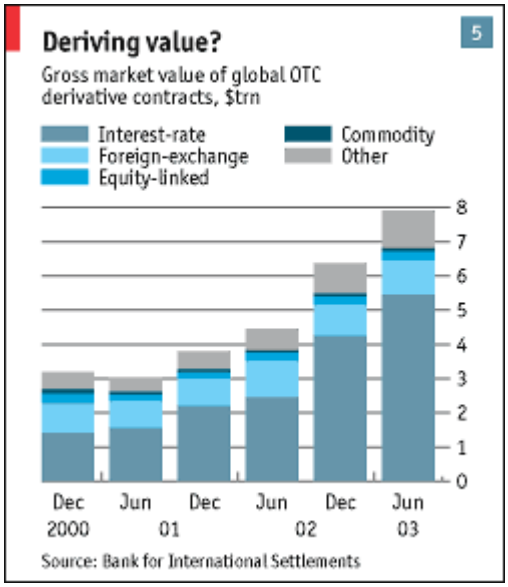
The good, the bad and the ugly

Derivatives are not exactly new—Japanese rice traders, for example, used futures in the 17th century—but they have become much more sophisticated in recent years. The modern toolbox consists mainly of futures and forwards (agreements to buy an asset in the future at a fixed price), options (which give you the right, but not the obligation, to buy an asset, say a share or a lump of foreign currency, in the future at an agreed price) and swaps (which enable you to exchange a future string of payments in one currency for one in another).

Such financial instruments, and combinations of them, come in two types. The first is the listed variety, such as call options (the option to buy) and put options (the right to sell) written on shares in the stockmarkets. The second, and by far the biggest, group is over-the-counter (OTC) derivatives, which are arranged between two parties. The outstanding value of OTC derivatives has been growing rapidly for the past 20 years (see chart 5).

Those that have caused most of the trouble make up only a small part of the total market. They are called exotic options, and have been responsible for many of the debacles in the 1990s, as well as for the troubles at Freddie Mac today. They are often so complicated that it takes a PhD in maths and days of computer

time to find out whether you have made a fortune or gone bust. Perhaps as a result, the popularity of exotics has waned somewhat.



What makes derivatives so useful, despite the dangers, is that they allow an ever widening array of risks to be traded. Weather derivatives, for example, can be written so that they will pay out if the temperature rises above a certain figure, which could be a boon for an electric utility in the summer, or if snowfall during the winter is lower than expected, which could help a ski resort.

In 2002, Goldman Sachs and Deutsche Bank set up a scheme to trade economic derivatives, which give punters a chance to take bets on the direction of macroeconomic variables such as unemployment and inflation. Speculators may view this as just another opportunity to take a punt, but the longer-term hope is that such markets can help lay off more fundamental economic risks. Trade unions, for instance, might buy an unemployment derivative to protect themselves against the consequences of their members losing their jobs. Robert Shiller, of Yale University, wants to see that kind of derivative widely used (see box).

However, bankers have become very concerned about financial derivatives again, much as they were in the mid-1990s (see table 6), according to a poll from the Centre for the Study of Financial Innovation. Like Messrs Buffett and Gross, they are particularly bothered about credit derivatives, more than about bad lending and poor bank management, the more usual banker's nightmares.

A credit derivative is a corporate contract that pays its holders if a certain company goes bust. The idea is that if you own a credit derivative for, say, General Electric (the “name”), and GE declares default on its debt, you will get paid. This is especially handy if you already own some of GE's bonds: the credit derivative can help limit your losses, in the same way that an insurance policy would. Such contracts have been booming in the past five years.

Losing sleep 6

Top five risks cited by bankers

1996	2003
Poor management	Complex financial instruments
Bad lending	Credit risk
Derivatives	Macroeconomic conditions
Rogue traders	Insurance
Excessive competition	Business continuity

Source: Centre for the Study of Financial Innovation

But will they pay up?

One particular cause for concern is counterparty risk—the possibility that people holding credit derivatives will not get paid by those who issued them. Credit derivatives are largely unregulated, so no one knows what would happen if there were lots of defaults. Another worry has to do with the legal structure of credit derivatives. They often fail to lay down clearly what would constitute a default for the purpose of triggering payment to holders of such derivatives. Mr Gross—along with the bankers—fears that credit derivatives could make the markets for corporate debt more jittery rather than stabilise them.

Mr Buffet's grouse is more practical and immediate. A few years ago Mr Buffett's firm, Berkshire Hathaway, bought General Re, an insurance firm, which like other big insurers and reinsurers had piled eagerly into the credit-derivatives market. But when the economic downturn came, such firms found they had to pay out billions, and General Re was hit especially hard.

Alan Greenspan of America's Federal Reserve, however, was having none of Mr Buffett's complaints. He quickly stepped in to praise credit derivatives for shoring up the stability of the global financial system. If insurance companies had chosen to sell protection on corporate debt of their own free will, that was their business.

Some derivatives, however, do seem to lend themselves particularly well to nefarious purposes. Their very complexity makes them perfect for foiling the rules of the equally complex tax codes of most rich countries. For example, they can be used to turn a capital gain into a temporary loss, a dividend or any other type of income that the taxman treats leniently. America's tax police are trying to crack down on this kind of thing.

America's accounting watchdog, the Financial Accounting Standards Board (FASB), has introduced a new

rule requiring companies to show whether they are using derivatives to hedge risks connected to their business, or whether they are just taking a risky bet. Genuine hedging, such as an airline buying forward against a rise in the price of jet fuel, is spared scrutiny, but less obvious hedges have to be carried on a company's books at their market value. This can cause wild fluctuations in a firm's income, so the rule should discourage the sort of punts that lack any clear economic logic.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

The missing market

Jan 22nd 2004
From The Economist print edition

Derivatives for everyday life

DERIVATIVES have been good for the big investment banks that sell them, and sometimes helpful to the companies that use them. But what about the man in the street? He will soon get his chance, if Robert Shiller has his way.

Mr Shiller, a professor at Yale University and author of a book entitled “Irrational Exuberance”, which in 2000 foretold the bursting of the stockmarket bubble, imagines a glorious future for personal finance. He predicts the rise of financial innovations that will help to take the risks out of everyone's lives.

Why, he asks, are there so few markets for hedging the most common types of risks people face? For example, you can buy disability insurance to protect you if illness prevents you from working, but not “livelihood insurance” to compensate you if your chosen career does not flourish. You can buy fire insurance in case your house burns down, but not “value insurance” that pays out if the market value of your house falls.

One problem with this kind of novel security would be “moral hazard”: the risk that, knowing they are insured, people will take less care to prevent the calamity in question. Insurance companies calculate that drivers will be more reckless if they know that someone else will pay for repairs. Similarly, people might work less hard if they knew they were insured against loss of livelihood.

Another problem is that traditional kinds of insurance (eg, fire, disability) affect relatively few people, although the loss to each of them may be large. A non-traditional insurance may pay out on much smaller individual losses, say a 5% decline in house prices, but may be spread far more widely, so the overall sums involved could be enormous. Who would be willing to bear that risk?

Mr Shiller dismisses these worries, pointing out that when fire insurance was first mooted, critics used the same arguments to predict that it would never take off. He hopes that these new financial products might lead to a flowering of human talent. By lessening the risk, it might encourage more students to become, say, violinists or research scientists rather than lawyers or accountants. Perhaps. Meanwhile, Mr Shiller's son hopes to apply for a place on an MBA course.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Be prepared

Jan 22nd 2004
From The Economist print edition

What companies must do to face a much-increased range of risks

MANAGING risk is one of the things that bosses are paid for. Yet risk is trickier to handle than mergers or product launches. It does not lend itself to forecasts or plans, but requires managers to look at a range of possible outcomes. Most people who run companies would be more comfortable with a single figure to aim for, even if in the end it turns out to be wrong. Financial tools such as derivatives have enabled them to trade away many risks, but there are plenty left that are simply part of doing business.

The range of risks that managers have to worry about has undoubtedly become wider. According to Jim Maxmin, who has been chief executive of a number of international companies, dealing with corporate risk used to be relatively simple. In the late 1970s, when he was running Volvo's UK division, most of the potential perils were the sort you could buy insurance for. You just had to make sure that the premiums were paid on time, he says.

By the 1980s, when Mr Maxmin was managing Thorn, a home-electronics firm, things had become more complicated. The company had operations in over 50 countries, and because of a surge in litigation in America had become the target of a growing number of lawsuits there. Increased use of technology made it vulnerable to fraud by both employees and outsiders. To manage its risks, the firm ran its own insurance outfit in Bermuda.

By 1990, when Mr Maxmin became chief executive of Laura Ashley, a retail firm, he was fully versed in the language of financial risks and returns, and was catching up fast on derivatives. But he thinks that being well up on financial risk alone will not necessarily help the manager of a business, because there has been a huge increase in risks of all sorts, from crime in retail stores to the prospect of terrorism.

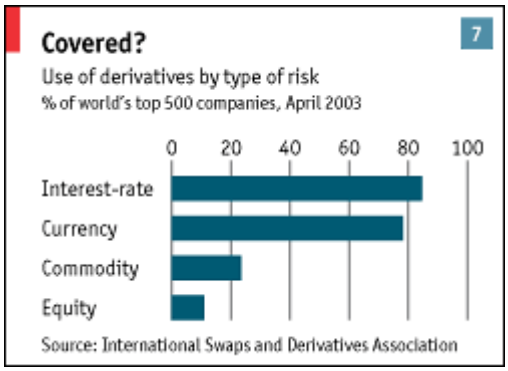
Traditional insurable risks have not only increased steeply, they have also become much more expensive since September 11th 2001. Moreover, the raft of corporate scandals has made directors' and officers' insurance policies (which protect top managers from civil lawsuits brought by shareholders) much pricier. And the familiar insurable risks have been joined by a whole new litany of worries.

Darrell Rigby of Bain, a management consultancy, explains that managers now have to be prepared for a range of risks that were unthinkable not long ago. Global supply chains expose them to potential calamities not only in their home country but all over the world. These disasters can be natural or man-made, ranging from forest fires in California and earthquakes in Turkey to dock strikes, power cuts, internet attacks and even top managers' hands in the till.

The traditional advice to managers is simple: identify your risks. Be prepared for each of them individually, and for the possibility of many of them occurring at the same time. Monitor and track your

risks as you go along. And when something untoward happens, make sure you move quickly to deal with it.

But all this is far more easily said than done. Merely identifying their risks defeats many. And, says Peter Kontes of Marakon, another consultancy, “most companies still don't have any idea what is required of risk management.” A study sponsored by McKinsey points in the same direction: 36% of the corporate directors polled actually admitted that they did not fully understand the risks faced by their company. Others may have had their doubts but did not like to say so.



Another reason why risk management is difficult to grasp is that it is by its nature defensive. In the late 1990s, companies spent millions on updating their computer systems to guard against the Y2K bug that was expected to create havoc on January 1st 2000. When nothing dreadful happened on the day, many felt duped. Managing risks can seem a waste of time and money—until something goes seriously wrong.

America leads the way

Most of the progress in corporate risk management over the past decade has been made in America. The discipline came of age as banks were grappling with their exposures to markets, but the same sort of techniques have spread to companies in everything from consumer products to aircraft makers. Because of its origins in the financial industry, risk management has put a lot of emphasis on techniques such as controlling a company's exposure to foreign-exchange rates and obtaining the best interest rate for its financing. A second American export was the elevation of formerly humble internal controllers and auditors to the grander-sounding chief risk officer.

In the 1990s, one company stood out for its risk management. Its chief risk officer, Rick Buy, was feted for his skills. The company pioneered contracts to provide its customers with fixed-price natural gas over long periods. This involved great market expertise, buying gas on the spot and futures market and arranging for delivery several years ahead at a pre-set price. The firm also devised sophisticated new financing arrangements in which assets were kept off the company's balance sheet. At first these deals were completely honest, but in time they became less so. The company was called Enron.

The firm that had become famous for its risk management turned out to be utterly crooked. That scandal has made boards look again at what their risk managers are doing, and what effect this is having on their corporate governance—a subject that only a few years ago was considered rather boring. One European executive recalls a gathering of risk managers in the mid-1990s at which corporate governance was being discussed. “Who cares?”, asked his American colleagues. They would be less nonchalant now.

Since Enron's collapse, there has been increasing scepticism over the value added (or subtracted) by risk management. Some companies are shying away from anything that looks like a derivative, says one academic, even when it is utterly safe and helpful, to avoid being tarred with the Enron brush.

That corporate disaster, however, has given all those responsible for risk management in their company a chance to start from first principles. Their job is likely to have become much more senior, or even expanded to involve several people on the board. No longer can risk management be delegated to an accountant or treated as part of a firm's insurance arrangements. Companies around the world are re-examining the way they handle risks, including new kinds.

All this means that when a company finds itself facing the unexpected, the board is no longer able to say it is unprepared, nor will it be able to blame its underlings. That is an improvement on previous practice, but it also means that a company's risk management is only as good as its board.

Because shareholders remain suspicious of the management of financial risks, the emphasis has shifted to operational risks, where the main priority is business continuity planning. Having seen what effect terrorism can have on a business, firms have become more determined to ensure that they can keep going even if a disaster happens. Spending on packages offered by various consultants under the heading “contingency planning” or “business interruption” has risen sharply.

One of the most resilient firms after the September 11th attacks turned out to be Lehman Brothers, an investment bank, which had offices just across the road from the World Trade Centre. Thanks to careful advance planning, it was able to set up shop elsewhere in New York almost immediately. Its computer systems allowed many of its staff to work from home, and others to set up shop in hotel rooms and rented space overnight. As a result, it came through the period after September 11th better than some of its competitors that suffered much less physical damage and disruption.

But it is not only New-York-based companies, or those elsewhere in America, that are becoming more security-conscious. Few parts of the world now feel safe from the risk of a terrorist attack, especially if the company concerned has a well-known brand name. One security consultant reports a surge of interest in his services from Australia in the wake of the Bali night-club bombing, which made that country aware that it too could become a terrorist target.

Terrorism, of course, is not the only unexpected risk that might ruin a business. Outbreaks of infectious diseases such as the SARS epidemic can be equally damaging. Most companies are still well behind with their contingency planning. In the past, says Bain's Mr Rigby, bosses were reluctant to draw up such plans in case they frightened employees and customers. Now, he says, “it's a necessity.”

The new concern with geopolitical risks has also led to a revival of scenario planning. Pioneered by Royal Dutch/Shell (which includes at least three different long-run forecasts of the global economy in its strategic planning decisions), scenario planning has been out of fashion for a decade because the geopolitical climate appeared to have become more benign. Now, however, it is regaining its popularity as a way of helping managers and directors to think about future uncertainties.

At Microsoft, Brent Callinicos, the company's treasurer, keeps track of six or seven different scenarios at a time. Microsoft also calculates and discloses its “value at risk”—an estimate of the greatest loss it is 95% sure it will not exceed—for 20-day periods ahead. But in itself that is not enough. Scenarios, he says, are crucial in putting the value-at-risk calculations into its proper context.

Microsoft's experience of risk management mirrors that of many other companies. The company once thought risk could be dealt with mainly by buying insurance and managing its insurance providers, but during the mid-1990s it started to take a much broader view. Nowadays Mr Callinicos monitors the full range of the company's risks, from finance to operations. Even that was evidently not enough to prevent its antitrust dispute with American regulators, but it may have mitigated the effects on profits.

Another push for risk management comes from initiatives sponsored by government or by the auditing industry, such as the Treadway Commission, an international body of auditors that has drawn up rules for enterprise-wide risk management. In Britain, the Turnbull Committee in 1999 set out a policy for internal control and risk management for all companies with a stockmarket listing. Rather than laying down hard-and-fast rules, it requires all corporate boards to identify and manage the risks as their own circumstances permit (and convince their shareholders that they are doing the right thing). It sounds permissive, but seems to have been more effective than a more quantitative approach might have been.

At Diageo, a giant drinks company, implementing the Turnbull Committee guidelines involves reporting from the bottom up on all the risks the company faces. At board level, all this information is distilled into a single “risk map” that describes both the likelihood of a risk occurring and the cost if it does. High on the list of Diageo's risks, for example, is that of a change in the public perception and regulation of alcoholic drinks. This is not the sort of thing that most internal auditors would have lost sleep over in the past, but thanks to the Turnbull Committee it is now receiving attention. Each kind of risk at Diageo is made the responsibility of a single manager. Richard Anderson, of the Corporate Risk Group, which advises Diageo on the company's risk management, explains: “It must be more than a box-ticking exercise to be useful.”

Companies on the continent of Europe tend to take a more down-to-earth approach. At Danone, based in Paris, risk management is closely linked to the day-to-day delivery of products. Thierry Van Santen, who is responsible for the company's risk management, is sceptical of scenario analysis. “You can look at hundreds of scenarios, and not a single one is going to come true,” he says. Nor does he worry much about things such as reputation and political risk: in his company, these are the responsibility of the board. Instead, he is concerned to ensure that the supply-chain stays intact and that shops around the world will continue to carry his products without mishap. The idea is that if a company pays enough attention to detail, it can cope with any scenario.

In Italy, too, pragmatism is the order of the day. Sergio Beretta of the University of Padua found that at

Fincantieri, a shipbuilder, risk management for the most part means preventing cost overruns, because customers these days demand much tighter contracts. European risk managers may now be wielding far more power than their American peers, possibly because their operational approach produces more concrete results than the financial approach in America.

In Asia, corporate risk management is catching on only slowly. The big risks at SK Telecom, a Korean mobile-phone operator, include rapidly changing technology and heavy regulation in the telecoms industry. The company is listed on the New York Stock Exchange, so it wants to be seen to be responsive to the demands of its investors in America. Such foreign listings are putting increasing pressure on Asian firms to be open about the risks they face.

The bottom line

Should a company even bother to manage risks? After all, its shareholders can diversify their holdings in portfolios to minimise their own risk exposure. And if they are uncomfortable with the company's level of risk, they can sell its shares or hedge against it. Perhaps companies should concentrate on making profits and let the shareholders do all the worrying about risks.

But in the real world, a firm's failure to manage risks can cause costs that shareholders do not want to bear. It can, for example, make it impossible for a company to get financing. Or, at a time when brands matter more than ever, it can ruin its reputation (see article). At the extreme, ignoring risks that cause unexpected losses can lead to bankruptcy. Managing a company's risks is no longer optional: it has become a core part of looking after its shareholders' interests.

It can also benefit the bottom line more directly. Oxford Metrica, a consultancy, studied over 400 publicly traded firms around the world to see how they protected themselves against natural hazards such as earthquakes, floods and storms. Among companies that manage these traditional risks well, it found a clear reduction in cashflow volatility over five years, which also meant that their shares performed better over that period than those of their peers.

In the end, it is still up to shareholders to monitor corporate risk management. But relying on them may be risky. Unless they make a better fist of it than of vetting corporate governance and executive pay, expect more volatile times.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Easy to lose

Jan 22nd 2004
From The Economist print edition

Reputations are precious—and fragile

THE biggest risk any company faces is the loss of its good name, and you cannot insure against that. Most boards are now paying much more attention to “reputational risk”—anything that could harm the image of their firm, from accounting irregularities to product recalls. The corporate scandals of the past few years have brought calls for greater transparency, and more corporate dirty laundry is now being aired. Aon, an American insurance company, recently surveyed 2,000 public and private companies and found that they viewed reputational risk as their single biggest business hazard.

It is not hard to see why. If a company suffers a blow to its reputation, it can collapse with astonishing speed. Arthur Andersen's clients deserted it long before the accounting firm had its day in court. When Putnam Investments, a mutual-fund company, came under scrutiny by Eliot Spitzer, New York state's attorney-general, its clients began to pull their money out of its funds literally overnight. Even if a company survives damage to its reputation, the loss of business can be devastating. Leslie Gaines-Ross, of Burson-Marsteller, a public-relations firm, has been advising companies on building their reputations for 20 years, but only in the past few years have companies started showing much interest in reputational risk, she says: “The entire subject is radioactive.”

Eliot Spitzer is not the only reason. Companies have also become much more concerned about other reputation-makers and –breakers: the government, the public and the media, and increasingly the internet, which has greatly improved transparency. Corporate secrets are becoming ever harder to keep.

Businesses are now finding that, perhaps unfairly, they are being judged by the company they keep. As they rely more on outsourcing, they may be held responsible for the sins of their subcontractors. Wal-Mart, a giant American retailer, was recently sued by the government for illegally using foreign workers to clean its floors. They were working for a subcontractor without Wal-Mart's knowledge, but the company still got a bad press. More unfairly still, the misdeeds of one company can tarnish all its competitors as well.

Some of the most vigorous wreckers of reputations have been NGOs. Greenpeace and Friends of the Earth now routinely picket and boycott firms of whose practices they disapprove, such as Nestlé, Esso and Shell. Companies that do business in poor countries (eg, Nike) are liable to find themselves charged with running sweatshops. But, says Ms Gaines-Ross, nothing compares with the damage a firm can inflict on itself. Ask Parmalat.

Not so long ago, the task of looking after a company's reputation was left mostly to its advertising and marketing departments, but the number and severity of threats (especially of the ethical and legal variety) has increased so much that now it often falls to the chief executive. To give him a hand, some firms—especially in industries with complex regulations—are also appointing chief legal officers.

Spending on public relations and crisis-management programmes may make some CEOs sleep easier, but much the most important thing is to avoid letting your reputation get sullied in the first place. As Jack Welch, GE's former boss, whose own halo got knocked by his lavish pay-off and perks, once observed, “Perception is reality.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Learning to live with uncertainty

Jan 22nd 2004
From The Economist print edition

Risk can be managed, but never eliminated altogether

NEW risks are always springing up to replace earlier kinds. Until recently, for example, economists worried about price deflation and plunging stockmarkets; now they fret over currency swings and the effects of a falling dollar. Happily, the war in Iraq, which the Fed's Alan Greenspan last year considered the biggest risk to economic growth, today looms less large.

A bigger reason for concern is the recent decline in corporate risk-taking. There are some signs that this may be changing: capital spending has been rising again. Yet the excesses of the boom years are still being worked off and will continue to have an effect for some time. Probably their most unattractive consequence is the raft of business scandals that have surfaced in the past few years.

Remember, though, that most of the corporate scandals concerned outright theft and corruption rather than excessively risky business plans. Indeed, the American government's legal case against executives at Enron turns not on the amount of risk they took on behalf of the shareholders, but on enriching themselves without ever risking their own money.

In the face of such scandals, it is tempting to call for new laws to prevent a recurrence, but that may not be the right answer. Governments have been introducing ever more legislation in the hope of protecting their countries from risk, especially the economic and financial kind. In America, many people now worry that the pendulum is swinging too far. They are concerned partly about proliferating business regulation and partly about legislation such as the Sarbanes-Oxley act, America's new corporate-governance code.

On the face of it the act is an eminently reasonable plea not to steal from shareholders. After all, the protection of property rights, including those of shareholders, lies at the heart of any system of risk-sharing and -shifting. Even so, new plans for improving corporate governance in America are not necessarily being welcomed with open arms these days. That is because company bosses are now facing a risk to which most of them are unaccustomed: prison. Not many are inside as yet, but a number of top managers at Enron have been indicted and a handful have already pleaded guilty. Many more American executives from firms such as Tyco and WorldCom may soon inhabit a prison cell. The penalties for infringing Sarbanes-Oxley, too, have a way of focusing the mind every time a corporate board meets.

Risk-taking with a heart

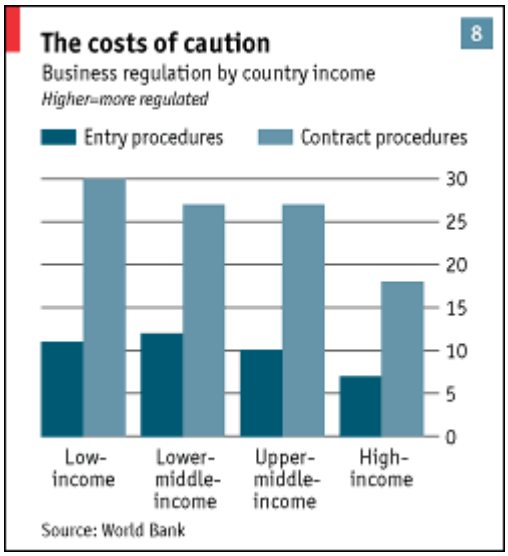
Outside America, taking a more risk-friendly stance is often caricatured as adopting a laisser-faire economic model and dismantling social protection, but this need not be so. The devil often lies in the detail of the welfare state, rather than in its overall aims. Europe is trying to find ways of spreading the

risks of unemployment, pensions and health care at the lowest possible cost. Denmark, for example, has a generous welfare state without unduly discouraging businesses from taking risks. Britain is hoping to boost its competitiveness by easing its bankruptcy rules, reducing the personal costs to entrepreneurs of going bust. More such changes could yield big gains.

Japan is an instructive example of what happens when a country fails to deal with risk properly. David Moss, of the Harvard Business School, argues that this failure explains much of that country's long economic malaise. The Japanese government, he says, has been too eager to step in to provide financial guarantees to stop banks from collapsing. The country's lack of an adequate social safety net may have exacerbated the problem. Because the costs of restructuring the economy would fall directly on individual workers, companies keep on workers they do not need, and banks endlessly extend credit.

No matter how hard they try, governments are unlikely to strike the right balance of risk and return for everyone. That is why they should allow markets—in anything from private pensions to derivatives—to enable individuals and companies to achieve their own balance. The most important thing governments can do is to make sure that the markets for risks work fairly. And they must not be too quick to step in to save people from their own mistakes.

Rigorous regulation is not confined to rich countries, and for poor ones the cost can be prohibitive. A recent study by a World Bank team under Simeon Djankov tracks the correlation between regulation of business and national income in 130 countries (see chart 8). Leaving aside property rights, it turns out that the poorest countries have the most rules. No doubt such rules are always drawn up with the best of intentions. But, argues Mr Djankov, many rules make poverty worse by making the returns from entrepreneurial risk-taking unattractive and by providing an avenue for corruption.



Over-regulation can also scare away badly needed foreign capital. According to a recent survey of corporate bosses conducted by A.T. Kearney, 72% of those polled thought that government regulation was the biggest risk in making new investments abroad. Only 21% cited terrorism as the top risk.

In developing countries, the use of markets to trade and share risk has barely begun. Enabling banks in poor countries to shift risks at the proper economic cost is bound to improve growth. Reducing the most common risks will provide big benefits, but it will also require big investments in the institutions that ensure fair play.

Yet none of the attempts to improve the management of risk will make the world perfect. Losses can be made more bearable, but there will always be losers. The biggest danger of all lies in thinking that you can beat risk altogether.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Acknowledgments

Jan 22nd 2004
From The Economist print edition

As well as those mentioned in this survey, the author would like to thank the following people for their time, help and insights: Robert Merton, Ken Froot and Peter Tufano of the Harvard Business School; Zvi Bodie of Boston University; Ken Rogoff of Harvard University; Darrell Duffie of the Stanford Graduate School of Business; Ortwin Renn of the University of Stuttgart; Robert Litterman of Goldman Sachs; Frank Partnoy of the University of San Diego School of Law; Nigel Turnbull of the Turnbull Committee; Andrew Hilton of the Centre for the Study of Financial Innovation; Rich Apostolik of the Global Association of Risk Professionals; Simon Bell of A.T. Kearney; Andrew Kuritzkes of Mercer Oliver Wyman; and David Ropeik of the Harvard Centre for Risk Analysis.

Many books have been devoted to risk and risk management, especially as practiced by corporate bosses and money managers. The books below, however, will interest experts and amateurs alike:

"**Against the Gods: The Remarkable Story of Risk**", by Peter L. Bernstein, John Wiley & Sons.

A splendid and essential history of mankind's progress in understanding probability and risk. The book is rich in historical detail and tells the story of risk through the lives of the people who conquered it.

"**When All Else Fails: Government as the Ultimate Risk Manager**", by David Moss, Harvard.

An excellent history of the American government's attempts to absorb a growing number of the risks its citizens face.

"**The Death of Common Sense**", by Philip K. Howard.

An American author looks at his country's legal system and how it deals with (and fails to deal with) risk.

"**The New Financial Order: Risk in the 21st Century**", by Robert Shiller, Princeton University Press.

The Yale University economist who predicted the bursting of the stockmarket bubble in 2000 describes a future in which the risks faced by people and governments are traded in new markets using novel types of securities and insurance.

"**Seeing Tomorrow: Rewriting the Rules of Risk**", by Ron S. Dembo and Andrew Freeman, Wiley.

A readable guide to managing business risks. This book emphasises the role of psychology in decision-making. Andrew Freeman is a member of the editorial staff of *The Economist*.

"**Modern Investment Management**", by Robert Litterman, Wiley.

A book aimed at Wall Street and City types who are charged with managing financial portfolios. Some of the ideas assume a fair bit of background in financial theory.

"**Managing Reputational Risk**" by Jenny Rayner, Wiley.

This book brings together the latest ideas for helping companies tackle the growing list of reputational risks.

"**Doing Business 2004**", World Bank.

A global study of the relationship between government regulations and the wealth of nations.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Offer to readers

Jan 22nd 2004
From The Economist print edition

Reprints of this survey are available at a price of £2.50 plus postage and packing. A minimum order of five copies is required.

Send orders to:

The Economist Shop
15 Regent Street, London SW1Y 4LR
Tel +44 (0)20 7839 1937
Fax +44 (0)20 7839 1921
e-mail: shop@economist.com

Corporate offer

For corporate orders of 500 or more and customisation options, please contact the Rights and Syndication Department on:

Tel +44 (0)20 7830 7000
Fax +44 (0)20 7830 7135
or e-mail: rights@economist.com

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Corporate social responsibility

Two-faced capitalism

Jan 22nd 2004
From The Economist print edition

Reuters

Corporate social responsibility is all the rage. Does it, and should it, make any difference to the way firms behave?

AT THIS year's gathering of underworked snow-loving corporate chieftains at the World Economic Forum in Davos, Switzerland, anti-capitalist protesters were expected heavily to outnumber the delegates. These rebels against the system could be forgiven for thinking that they have been making progress: they were literally out in the cold this week, but metaphorically speaking they are warming themselves at corporate hearths everywhere. Companies, governments and international organisations pander to them eagerly. Good corporate citizenship is (again) a theme of the Davos celebrations.

One of the biggest corporate fads of the 1990s—less overpowering, no doubt, than dotcom mania, but also longer-lived—was the flowering of “corporate social responsibility” (CSR). The idea that it is not enough for firms to make money for their owners is one that you might expect to be an article of faith among anti-globalists and eco-warriors. Many bosses now share, or say they share, the same conviction.

In a survey of the 1,500 delegates (most of them business leaders) attending the Davos meetings, fewer than one in five of those responding said that profitability was the most important measure of corporate success. Admittedly, even fewer, just 5%, named CSR in its own right as the single most important criterion; but one might add to this the additional 24% who said that the reputation and integrity of the brand, to which good corporate citizenship presumably contributes, matter most. (The quality of the product was the highest-scoring category, with 27%.) When asked to name the leading threat to “security and integrity of the corporate brand”, 38% of the businessmen who responded said “economics/markets”. Evidently, not all the anti-capitalists in Davos are huddled outside the conference rooms.

There's profit in it

CSR, at any rate, is thriving. It is now an industry in itself, with full-time staff, websites, newsletters, professional associations and massed armies of consultants. This is to say nothing of those employed by the NGOs that started it all. Students approaching graduation attend seminars on “Careers in Corporate Social Responsibility”. The annual reports of almost every major company nowadays dwell on social goals

advanced and good works undertaken. The FTSE and Dow Jones have both launched indices of socially responsible companies. Greed is out. Corporate virtue, or the appearance of it, is in.

Is this a good thing? Possibly not. From an ethical point of view, the problem with conscientious (as opposed to fake) CSR is obvious: it is philanthropy at other people's expense. As a rule, so far as public companies are concerned, managers do not own the firms they work for. They are entrusted with the care of assets belonging to others, the firm's shareholders. Supporting good causes out of their own generous salaries, bonuses, deferred compensation, options packages and incentive schemes would be admirable; doing it out of income that would otherwise be paid to shareholders is a more dubious proposition. Anyway, is it really for managers and NGOs to decide social-policy priorities among themselves? In a democracy, that is a job for voters and elected politicians.

Advocates of CSR typically respond that this misses the point: corporate virtue is good for profits. And so it may be, on occasion. The trouble is, CSR that pays dividends, so to speak, is unlikely to impress the people whose complaints first put CSR on the board's agenda. So there is a dilemma. Profit-maximising CSR does not silence the critics, which was the initial aim; CSR that is not profit-maximising might silence the critics but is, in fact, unethical.

An unusually persuasive advocate of the view that CSR—or "compassionate capitalism", as he calls it—benefits shareholders, employees and the needy all at once is Marc Benioff, boss of salesforce.com, a private company (for now) that provides online customer-relationship-management services. In a new book, co-written with Karen Southwick, Mr Benioff argues that corporate philanthropy, done right, transforms the culture of the firm concerned*. "Employees seeking greater levels of fulfilment in their own lives will have to look no further than their workplace." As well as doing the right thing, the firm will attract and retain better people, and they will work more productively. He makes it seem plausible.

Mr Benioff advocates "the 1% solution": 1% of salesforce.com's equity, 1% of its profits and 1% of its employees' paid hours are devoted to philanthropy, with workers volunteering their time either to company-run schemes or to charitable activities at their own initiative. His book describes similar projects at many other firms, always underlining their win-win character.

Unlike some advocates of CSR, Mr Benioff says he opposes government mandates to undertake such activities. Compulsion would neutralise the gains for corporate culture, he points out. (He is not averse to tax relief, however, and complains that America's corporate-tax code does too little to encourage his charity.) In any case, if Mr Benioff is right, and CSR done wisely helps businesses succeed, compulsion should not be needed. Companies like salesforce.com and the others discussed in his book will thrive, and the model will catch on by force of example.

Lack of compulsion, however, is exactly what is wrong with current approaches to CSR, say many of the NGOs that first put firms on the spot for their supposedly unethical practices. This week Christian Aid, with Davos in mind, published a report claiming to reveal the true face of CSR†. The charity is "calling on politicians to take responsibility for the ethical operation of companies rather than surrendering it to those from business peddling fine words and lofty sentiments." (If Christian Aid has no time for lofty sentiments, one wonders, who does?) It regards CSR as a "burgeoning industry...now seen as a vital tool in promoting and improving the public image of some of the world's largest companies and corporations."

The report features case studies of Shell, British American Tobacco (BAT) and Coca-Cola—all of them, it says, noted for paying lip-service to CSR while "making things worse for the communities in which they work." Shell, says the report, claims to be a good neighbour, but leaves oil spills unattended to. Its community-development projects are "frequently ineffective". BAT, it says, claims to give farmers training and protective clothes; contract farmers in Kenya and Brazil say otherwise. Coca-Cola promises to use natural resources responsibly. The report accuses an Indian subsidiary of depleting village wells. So, "instead of talking about more voluntary CSR in Davos, government...should be discussing how new laws can raise standards of corporate behaviour."

This is a switch. CSR was conjured up in the first place because government action was deemed inadequate: orthodox politics was a sham, so pressure had to be put directly on firms by organised protest. Ten years on, instead of declaring victory, as well they might, disenchanted NGOs like Christian Aid are coming to regard CSR as the greater sham, and are calling on governments to resume their duties. Might this be a sign, Mr Benioff notwithstanding, that CSR has finally peaked? If so, it might be no bad thing. If bosses are no longer to get credit for pandering to their critics, they may as well go back to doing their jobs.

* “Compassionate Capitalism: How Corporations Can make Doing Good an Integral Part of Doing Well.” Career Press, $15.99

† “Behind the Mask: The Real Face of Corporate Social Responsibility.” www.christianaid.org.uk

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Hollinger's troubles

Triumph of the twins

Jan 22nd 2004
From The Economist print edition

Enter the Barclay brothers. Exit Lord Black

AFTER two months of giving in to the demands of his enemies, Conrad Black has gone out fighting. On January 18th, an agreement was announced that his firm, Ravelston, would sell Hollinger Inc, a holding company that owns 30% of the shares and 73% of the voting rights of Hollinger International, a newspaper company, to some wealthy British twins, Sir David and Sir Frederick Barclay (pictured getting their gongs). Although Lord Black will lose his newspapers, the sale will presumably allow him to maintain his opulent lifestyle, while the Barclay money should quell Hollinger Inc's looming debt crisis.

News of the transaction threw Hollinger International's board into confusion, since Lord Black faces a continuing investigation and legal action for allegedly taking money from the company without authorisation. Now a special committee is trying to work out whether the deal with the Barclay brothers is good for Hollinger International's shareholders and whether or not the board has the power to stop it. It is unlikely that it can, because Lord Black has the right as owner of Hollinger Inc to sell, and the deal does not concern Hollinger International directly. America's Securities and Exchange Commission filed a highly unusual injunction last Friday to safeguard the company's investigation into Lord Black and other colleagues against a change in control, but signalled that it will not try to stop the deal.

Lord Black, who was ousted as chairman of Hollinger International on January 17th, also told the firm that he will not repay the $7.2m he agreed last November to give back. This money had been paid to him in the form of “non-compete” fees that the company later said were not properly authorised. Now Lord Black is citing previously unavailable documents which, he says, prove that the payments were in fact officially approved by board members and by KPMG, the auditors. He has also asked a Canadian court for an injunction to stop the board of Hollinger International from blocking his sale to the Barclay brothers.

Just hours before Lord Black announced his deal, Hollinger International filed a lawsuit against him, demanding that he and his associates repay more than $200m, which dwarfs last year's demand for $32m. As part of its evidence, the lawsuit cites e-mails from Lord Black to show what it calls Hollinger International's corporate culture of “controlling shareholder entitlement”. In one, Lord Black wrote that every time he gets on the corporate jet he worries about whether it is affordable, but that he is not prepared to “re-enact the French Revolutionary renunciation of the rights of nobility”. In another he wrote that “We have said for some time that (Hollinger International) served no purpose as a listed company other than relatively cheap use of other peoples' capital”.

The Barclay brothers, who are curiously reluctant to reveal the origins of their wealth, are paying $465m, which is very little, for control of Hollinger International and its stable of famous newspapers, including Britain's *Daily Telegraph*. That has further upset minority shareholders, who think that the Telegraph Group alone could be worth as much as $1 billion. They want to get a proper valuation for their shares, and not one obtained by selling out, since they think that Hollinger International's share price severely undervalues its assets. Until recently shareholders were happily waiting for Lazard, an investment bank hired to produce a strategic review for Hollinger International, to get on with selling the company's assets for a big premium. Under the deal with the Barclays they will get no cash at all and may never realise the value they would have expected from an auction. As controlling shareholders, the Barclay brothers are unlikely to agree to sell the *Daily Telegraph*, the main object of their bid, and may well keep the *Spectator*, the *Chicago Sun-Times* and the *Jerusalem Post*.

Shareholders reckon that they have leverage over the new owners because of all the lawsuits swirling around Hollinger Inc. Investors who collectively own over half of Hollinger International's shares have banded together to seek legal advice. They have been told that Lord Black's legal liabilities will transfer to the new owners. “All the hell that was reserved for Conrad will be unleashed on them,” says a person close to the shareholder group. For that reason, shareholders think that the Barclay brothers will be obliged in one way or another to make a deal and pay them money, over and above what they win back by suing Lord Black and others.

Buying into the Hollinger mess is a bold move by the Barclay brothers, who already own other British newspapers, including the *Scotsman* and the *Business*, as well as London's Ritz hotel and Littlewoods, a mail-order firm. They may still back out if they discover more legal risk than they originally bargained for. For now, though, the many other companies and individuals who wanted to get their hands on the *Daily Telegraph* and other assets have been abruptly sidelined by the reclusive brothers, who live in a castle on a tiny island called Brecqhou in the Channel Islands. Two determined British bidders, the Daily Mail and General Trust Group, which owns the *Daily Mail* in Britain, and Richard Desmond, owner of Express Newspapers, will be particularly disappointed. It remains to be seen what, if anything, minority shareholders in Hollinger International can do to retrieve the situation for themselves. Yet again, even on his way out, Lord Black has found a way to infuriate them.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

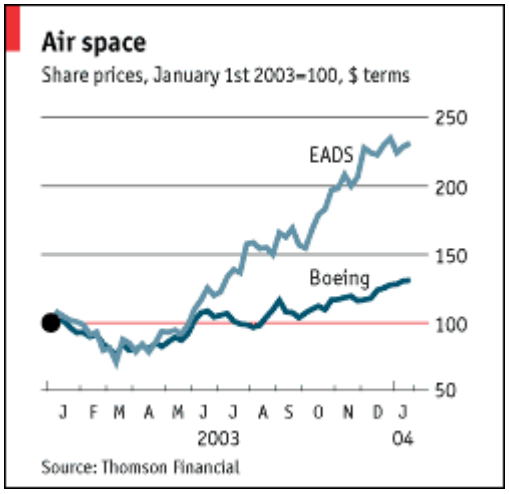
Military aircraft

Boeing down, again

Jan 22nd 2004
From The Economist print edition

Airbus has trumped Boeing yet again, winning Britain's air-tanker order

Get article background



NOT content with thrashing Boeing in passenger jets, Airbus and its parent company, EADS, are eating into Boeing's military market for cargo and tanker planes, where it hitherto faced little competition. The performance of the firms' shares tells all (see chart).

Last May, Airbus's military subsidiary beat Boeing in a contest to supply seven European countries with a military cargo plane. The Europeans chose a new Airbus aircraft, the A400M, over Boeing's tried-and-tested C-17 cargolifter, in a deal worth €20 billion ($23 billion).

The latest blow to Boeing is a £13 billion ($24 billion), 27-year deal to provide air-refuelling services to Britain's Royal Air Force (RAF). Boeing partnered with BAE Systems (formerly British Aerospace) and Serco (a firm specialising in public-private partnerships) to pursue the RAF deal, which involves both the long-term provision of a refuelling service and the air tankers themselves. Their offering would convert 19 redundant British Airways Boeing 767 passenger aircraft into tankers.

EADS leads a rival consortium known as AirTanker, which would use 17 new and second-hand Airbus A330 passenger jets, which have a bigger payload and a longer range than the Boeings. Senior sources close to the Boeing bid are now privately conceding defeat, alleging that EADS has priced its bid low in its desperation to land the deal. The price of the aircraft is only a tiny part of the total value, most of which lies in the provision of a “filling station in the sky” service anywhere the RAF needs it—so Boeing's plan to use older aircraft did not give it an economic edge.

The AirTanker consortium refuses to comment, except to say that it expects a decision to be announced shortly. Losing the order is more of a disappointment for Boeing than for BAE Systems: at least the British firm, as a 20% shareholder in Airbus, will get a slice of the profit on the supply of the aircraft. But Boeing is already struggling to secure a $22 billion leasing contract for 100 tankers from the Pentagon, which has been suspended pending an investigation into the circumstances surrounding the deal. Boeing's finance director, Mike Sears, was sacked in late November for contacting the government official in charge of the contract about a job at Boeing after she left the Pentagon. Mr Sears maintains that he did nothing wrong.

In a blatant attempt to curry favour with the British government, Boeing indicated that, if it won the tanker deal, it would increase the civil sub-contracting work it already places with BAE—especially for wing manufacture, in which the British firm is a world leader.

Perhaps Boeing, which has numerous joint ventures with BAE, should now consummate a much-mooted merger with the British firm—which actually makes 34% of its £12 billion sales in North America, compared with under 20% in Britain. Otherwise, on recent form, Boeing will probably lose it to some other predator.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Counterfeit goods

Psst. Wanna real Rolex?

Jan 22nd 2004 | BEIJING
From The Economist print edition

Chinese consumers are discovering the delights of buying the real thing

SELLING genuine watches in China might sound like a tough challenge. The country is one of the biggest and best producers of fakes, including reproductions of expensive foreign watches that sell for a tiny fraction of the price of the real thing.

Given China's awful record on the protection of intellectual-property rights, you might expect foreign luxury brands to stay well away. Yet Swiss exports of watches to China are growing fast, to nearly $150m last year. Last week, Omega, part of Switzerland's Swatch Group, opened its first “flagship store” in downtown Beijing.

A few kilometres east of the luxury hotel in the city centre where the Omega shop is located, hawkers in Beijing's famous Silk Alley display trays crammed with fake watches. A man's Speedmaster Broad Arrow, a type that costs more than 100,000 yuan ($12,000) at the new Omega shop, goes for less than $80 in fake form. Yet Kevin Rollenhagen, the head of Omega's operations in mainland China and Hong Kong, says he does not believe Chinese are natural consumers of fake products “if they can afford the real thing.”

Statistics and anecdotal evidence suggest that he may be right, at least when it comes to expensive watches. While many Chinese do buy fakes, they are generally not among Omega's target customers—the very rich. One of the most telling signs of Chinese demand for the genuine article can be found in Hong Kong, where Omega officials say that some 50% of sales are to visitors from the Chinese mainland. As Omega watches cost more than $1,000, those buyers must be members of a wealthy elite who still think the watches display their owner's status, despite the prevalence of replicas.

Omega opened its first mainland store not in one of the booming coastal cities but in Shenyang, capital of Liaoning Province in the decaying industrial north-east. The region may be struggling, but there is still money around, much of it in the hands of officials. One of the region's biggest corruption cases involved Shenyang's then mayor, Mu Suixin, who was noticed by a Hong Kong reporter wearing an expensive imported watch that was far beyond what he should have been able to afford on a mayor's salary. Investigators reportedly found more than 150 genuine Rolexes stashed away at Mr Mu's home.

Mr Rollenhagen says that Omega's sales in China are growing by about 15% a year. The country is among the ten biggest markets for the brand. True, the rate of growth is “slowing down a bit” as China lowers import barriers (easing the entry of rival brands and other luxury goods) and urban Chinese spend more on formerly state-provided necessities such as healthcare and housing. National pride stopped Omega winning rights to be the official watch of China's first spaceman, who orbited the earth last year. That honour went to a Chinese brand, Fiyta. As for fakes, there is no sign yet that the pirates in Silk Alley are running out of time.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Russia's business rows

Meet the oleagarchs

Jan 22nd 2004 | MOSCOW
From The Economist print edition

Russia's power-brokers must now fawn at the feet of capricious officialdom

FOR seven years, VimpelCom, one of Russia's big mobile-phone companies, has provided a GSM roaming service without a hitch. But last month, the telecoms regulator decided to do a spot check and was shocked to discover that VimpelCom did not have a GSM licence for the Moscow region. The licence belongs instead to KB Impuls, a firm that Vimpelcom wholly owns—an arrangement approved by the regulator in 1998. Now it wants the two firms to straighten things out by February 1st. How, it did not say; but re-registering the licence in VimpelCom's name, or signing up its 5.6m customers in the region to KB, would take months.

Industry analysts allege that senior figures in the telecoms ministry have ties to MegaFon, another mobile operator. One of VimpelCom's shareholders, the Alfa group, bought a blocking stake in MegaFon last summer. Disputes over that acquisition and the running of MegaFon are thought to have set off the regulatory spat.

In other words, it is business as usual in Russia. Analysts have, almost as one, issued hasty reports assuring their clients that the government's meddling with Alfa, one of Russia's biggest firms, with everything from oil to banks to supermarkets, is nothing like the prosecutors' campaign against Yukos-Sibneft, the country's biggest oil company, which led to the jailing last autumn of its boss, Mikhail Khodorkovsky. Unlike Mr Khodorkovsky, who is believed to have earned the Kremlin's wrath for wading into politics, Alfa's owners have steered clear of the political realm.

But thanks to the errant oilman's woes, Russia's other “oligarchs” are turning distinctly oleaginous. Vladimir Potanin of Interros, an industrial and media consortium, raised eyebrows this month by making a presentation about his investment plans—not to shareholders, but to the Kremlin. Lukoil, Yukos-Sibneft's main rival, pre-empted government plans to close tax loopholes that have saved the oil firms billions of dollars in the past by announcing that it would forgo them voluntarily. The latest charge against Yukos-Sibneft is that it owes 98 billion rubles ($3.3 billion) in unpaid taxes for 2000—a sum which, Yukos-Sibneft says, would have left it virtually without profits.

Many Russian firms were sold to their current owners under shady privatisations in the 1990s that left plenty of skeletons that prosecutors could choose to pull out of their closets. But the mobile-phone industry started from scratch. As a result, says Alexander Izosimov, VimpelCom's boss, “until this situation, telecoms had been seen as a relatively safe harbour to invest in.” Now, as the analysts' reaction shows, investors are more jittery.

The firm is taking the government to court, and Mr Izosimov is quietly confident that a way out will be found. It may well be. In 2000, the ministry tried to force VimpelCom and another firm to hand over some of their frequencies to a third—which, coincidentally, was subsequently acquired by MegaFon. After a quiet intervention from the Norwegian government, whose Telenor owns a quarter of VimpelCom, the ministry backed off. Having the right contacts could save VimpelCom again. But it is an unpleasant reminder to everyone else in Russia that no matter what your business, your *krysha*—the “roof”—had better be a solid one.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

European road tolls

Road rage

Jan 22nd 2004 | FRANKFURT
From The Economist print edition

Germany's truck tolls crash

IT WAS meant to be a showcase for public-private partnership: harnessing satellite-positioning technology and mobile telephony to charge trucks for using German motorways. But the project is in tatters, mainly because of problems with software, and is costing the government around €6m ($7.4m) a day in lost revenue. It is unlikely to start working before the autumn, despite angry threats from Chancellor Gerhard Schröder to cancel the contract and start all over again.

DaimlerChrysler, Deutsche Telekom and Cofiroute of France make up the hapless consortium behind Toll Collect. It has been paying penalties for the failure since December 1st, but only €250,000 a day. An arbitration panel will decide how much more it must pay; an opening offer from Toll Collect reportedly stands at €500m. The eventual shortfall for the government is likely to exceed €2 billion.

There are knock-on effects elsewhere. Since the end of last August all new road works and related public-works projects have been put on hold because of the revenue shortfall. The building industry anticipates that a quarter of transport ministry projects may be cancelled in 2004, threatening 70,000 construction jobs.

More happily for some, the 1.4m heavy trucks that use German motorways each year—400,000 of them foreign—have been getting a free ride. And the 800 ministry staff supposed to be checking tolls are instead carrying out vehicle-safety checks.

Toll Collect has until the end of January to come up with a new launch timetable, and must agree to pay higher penalties for any more overruns. If its plan is unconvincing, the transport ministry already has ample grounds to cancel the contract. But then Germany could be years away from having a working system.

A possible alternative is a rival Austrian/Italian system called Europpass, which is based on a short-range radio system installed on tollgates. But it too has teething troubles: false readings, for example, from trucks with metallic windscreens. Toll Collect's system is tantalisingly close to the ideal concept for an enlarged EU, because new road systems, and even entire countries, could be added without building new infrastructure.

Toll Collect involves installing in trucks a unit about the size of a radio. This identifies the truck and its position to a control centre, which avoids the need to build hundreds of checkpoints. But important features were left out of the software, such as the ability to work with the payment cards and accounting systems used by most trucking firms. Worse, gremlins charged trucks for being near motorways, rather than on them, or drained batteries while engines were switched off.

Toll Collect remains confident. It is expected to propose phasing in charging in October with the full system running by the start of 2006. And the government's revenue shortfall? One thought is to let VIFG—a government agency set up last year to channel revenues from roads, shipping and waterway charges into infrastructure projects—to borrow €2.1 billion against future cash flows. But that requires a change in VIFG's charter. The only people smiling are the truckers, many of whom are not German taxpayers.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Business schools

MBAs for anoraks

Jan 22nd 2004 | SAN DIEGO
From The Economist print edition

Can a new business school teach techies to lead?

Get article background

AMERICA'S top business schools are still struggling to overcome the hype of the boom years. Applications for places on MBA courses are well below their peak. The high came soon after the stockmarket and dotcom booms collapsed, leading suddenly unemployed bankers and dotcommers to seek refuge in the ivory tower until six-figure salaries and easy share-options resumed in the real world.

HBS

Harvard MBAs do it without anoraks

For those in business school today, employment prospects have brightened a bit, but multiple job offers and signing bonuses are but a dream. Overall, high expectations have been dashed, and the value of an MBA has been called into question. The last thing the world needs now, you might think, is another business school.

But that is exactly what is being built at the University of California, San Diego. With a budget of $120m, including a $30m grant due to be announced on January 22nd by Ernest Rady, a property and banking magnate, UCSD's Rady School of Management will admit its first full-time class in 2005. This is one of the few business schools to be established at a big American university since the late 1940s, when there was a rush to embrace “management science”. The new school will be run by Robert Sullivan, formerly the dean of the Kenan-Flagler Business School at the University of North Carolina.

The school's approach aims to differ sharply from its rivals. It will focus much more on educating managers who can launch and run science and technology firms. That makes some sense, since UCSD has already spun off dozens of companies based on the biotech ideas of its faculty. Yet all too often, laments Mr Sullivan, founders have had good ideas but lacked the requisite business skills to expand their firms. He thinks an MBA can help anoraks who have succeeded in the lab prosper in the boardroom as well.

Perhaps Mr Sullivan's most radical idea, at least as far as American management education goes, is that he can mould the personalities of techies into those of leaders. Business leaders are made, he thinks, not born. Moreover, he wants to make them leaders early in their careers, recruiting engineering and science graduates straight from university, bucking the trend among business schools of requiring up to five years of work experience.

Contrast this with the thinking now in vogue at America's long-established top-tier schools, such as Harvard, Stanford and Wharton. They were widely accused of churning out graduates who, though highly

numerate and well-versed in theories of corporate strategy, lack any idea of how to manage people or communicate ideas. These schools have responded to critics by trying much harder to admit students who already have “leadership” and “people” skills. The idea is then to teach them about finance, strategy and so forth. Nowadays, a Harvard MBA student is likelier than ever to have had a previous career as, say, an actress, salesperson or lobbyist.

Can you really teach geeks how to lead? Mr Sullivan is confident that natural reticence can be overcome, and that techies can blossom into top bosses. He is betting that, for example, courses in improvisational comedy and drama will help his students. A stronger draw for techies may be to work with other academics on the campus, a combination that might generate the next big idea in biotech or electrical engineering. Integrating the business school with other campus faculties, as he plans to do, has been an idea tried at other places, but rarely achieved.

And yet, is it really needed? After all, Bill Gates has done quite well, geeky reticence and all, despite lacking an MBA. So, too, Oracle's Larry Ellison, who nobody could accuse of needing a course in improvisational comedy.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Face value

Mr Protectionism's riskiest call

Jan 22nd 2004
From The Economist print edition

AP

Is Wilbur Ross's strategy of betting on protectionism starting to unravel?

AS AN investor in troubled and bankrupt firms, Wilbur Ross can boast of turning round a bust Japanese bank, butting heads with South Korea's militant labour unions and tackling the corporate wrecks that litter America's telecoms industry. Most recently, Americans have toasted Mr Ross as the saviour of their steel industry, much of which he has bought out of bankruptcy, merged and restructured. Last month, Mr Ross floated his steel firm, International Steel Group, on the stockmarket, turning an $80m investment into shares worth $1.3 billion.

With success like this, investors in the family of so-called “vulture” funds (Mr Ross prefers to call them “recovery” funds) run by Mr Ross's firm, WL Ross & Co, are naturally anticipating more magic in America's textile industry, where he has recently made big bets. However, Mr Ross now finds his meticulously tailored plans for textile-makers seemingly in jeopardy.

Mr Ross will soon control two American textile manufacturers: Burlington Industries, a clothing-to-carpet maker that he bought out of bankruptcy last November for $614m; and Cone Mills, a bust denim manufacturer for which he is the sole bidder. He may soon add a third bankrupt firm, Galey & Lord, to his interests. His strategy in textiles appears to be similar to the one he followed in the steel industry. This is sometimes characterised as “betting on protection”—taking stakes in industries likely to benefit from swelling anti-free-trade sentiment, as America's steel industry did when President George Bush slapped (now-lifted) tariffs on steel imports in March 2002.

But Mr Ross's tactics are more nuanced than that. His key contribution in steel was to cut a deal with the United Steelworkers of America, the industry's powerful union. Its hostility to reform had hitherto frustrated management efforts to cut labour costs. By championing the union's protectionist line, Mr Ross gave it cover behind which it agreed changes essential to compete against cheaper foreign rivals: fewer jobs, reduced pension and health-care benefits, and modern work rules.

From this sprang Mr Ross's Free Trade for America Coalition (Freetac), a grouping of beleaguered manufacturers and agricultural interests that he launched in September, ostensibly to widen the battle against “unfair” trade. Among Freetac's founding members were two big textile lobbies, the American Manufacturing Trade Action Coalition (Amtac) and the American Textile Manufacturers Institute (ATMI). But by last month, this budding relationship had hit the rocks, as Amtac and ATMI split with Mr Ross over

a proposed new Central American Free Trade Agreement (CAFTA—see article), which he backed. ATMI says that 95% of the textile industry is against CAFTA, and calls Mr Ross an “outcast”. Jock Nash, the general counsel at Milliken, a big textile firm, calls the concessions that Mr Ross claims to have won for American textile firms out of the CAFTA talks “bullshit”.

At first blush, the textile industry ought to have been less of a challenge for Mr Ross than steel. Making textiles is relatively capital-intensive, and the unions do not play a big hand in shaping trade policy on textiles. It is the mill owners, through their trade associations, who influence trade rules. Mr Ross charmed the steel unions, but cannot win over the textile capitalists.

His pitch to the textile-makers seemed clever. In 2005, an ancient quota system that shields rich-country textile-makers from poor-country exporters is to end. Lobby groups from America's retailers say that, without serious restructuring, the end of quotas is likely to kill domestic textile-makers, which make much of their money by exploiting current trade rules that, among other things, heap costs on foreign firms by forcing production to be spread across many countries. Once the quota system is abolished, say the retailers, they will be seeking integrated suppliers in Pakistan, India, China and Vietnam, who can do everything from make the cloth to stitch the clothing.

A stitch up?

Mr Ross's counter to the Asian threat was, in essence, to propose a free-trading textiles zone for the Americas, in which American, Mexican and other textile-makers could export to garment stitchers in central America and the Caribbean for duty-free re-importation to America. Even after the end of quotas, Asian producers will still face tariffs. These tariffs, plus the advantages of a supply chain closer to America, and the need for retailers to diversify suppliers, ought to be enough to offset cheaper Asian labour costs, figured Mr Ross—as long as the domestic industry also merged and trimmed itself into better shape. Happily, this would help Mr Ross's companies, which have plants in Mexico, and position him as the industry's consolidator. Politicians and trade officials leapt on board.

But Amtac and AMTI protest that Mr Ross's proposals help him but hurt other American manufacturers, by providing more reason to move production abroad. They say they will not agree to any deal that harms American manufacturers. “This billionaire guy came like a knight in shining armour,” says Mr Nash. “He made all the right noises, and seemed like one of us. But all he's won is a fraction of a fraction of the industry.” With Amtac's hostility (so far, it has built a coalition of 18 manufacturing associations against Mr Ross), CAFTA looks dead, at least in its present form, as do Mr Ross's plans for the industry.

Or do they? If the retailers are right, America's textile-makers have been cosseted for so long that they have lost touch both with customers (Mr Nash calls retailers “bastards”) and with their likely fate after the end of the quota system in 2005—probably, a rash of bankruptcies like that which overwhelmed the steel industry. Mr Nash, pointing to his 19 years in textiles, scorns Mr Ross, who he says is “just passing through”. But Mr Ross has his own 20 years (and more) in the bankruptcy business. More often than not, he gets what he wants in the end.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

General Motors

Cadillac comeback

Jan 22nd 2004 | DETROIT
From The Economist print edition

Signs of recovery at the world's biggest car company

THE magic of the Cadillac of the 1950s, with its outrageous tailfins, gleaming chrome and candy-coloured bodywork, could be coming back to rescue General Motors. Against all the odds, the world's biggest manufacturing company has turned around its ailing luxury-car division with a parking lot of exciting new models that are drawing buyers away from staid Lexuses and BMWs. Plans are afoot once more to export Cadillacs to Europe, where the brand that best symbolised American four-wheel luxury lingered on long after the car itself had vanished. GM's bosses, now ensconced in the aptly named Renaissance Centre on the banks of the Detroit River, are ever more confident that they can apply the Cadillac magic to GM's mass-market brands, such as Chevrolet and Pontiac.

AP

Rick Wagoner and Bob Lutz are enjoying the ride

Wall Street seems to agree. Stock analysts normally disdainful of Detroit as a destination for investors' money have taken to praising GM. Its shares have risen by nearly 35% since November. At their lowest, in March last year, they dipped below $30; this week they topped $55. But GM, like the other “Big Three” Detroit carmakers (Ford and Chrysler), is still embattled. It is facing growing competition from foreign brands, and it has been forced to offer discounts averaging about $3,785 per vehicle just to keep sales moving.

On January 20th, the company announced its 2003 profits. Excluding the recently sold Hughes Electronics business and some other items, profits fell by 18.6% on the previous year. Profits from car sales in North America tumbled by nearly two-thirds, to barely $1 billion, dragged down by a charge of $2.6 billion for GM's huge pension scheme. A fall in car profits overall, from $2.5 billion to $1.1 billion, was not offset by a $923m rise in profits from the group's financial businesses. So, apart from the renewed gleam from Cadillac, what is driving up the share price?

There are obvious external factors, such as the recovering economy in America, where car sales are set to rise from 16.7m vehicles last year to 17.3m this year, according to GM's own forecast. The share prices of car firms tend to recover smartly, outperforming equity markets early in any economic recovery. Yet GM's fourth-quarter results, also published on January 20th, showed a worrying fall in net profits compared with the same quarter in the previous year. The good news is that, at $674m ($1.41 per share), earnings exceeded analysts' expectations (of only $1.22).

Wagoner's roll

This could prove to be the year when GM's core business of making cars comes in from the cold. Some analysts see car profits doubling to $2 billion, and this week John Devine, GM's chief financial officer, forecast that the group's net earnings per share would rise by 24% (to $1.75) in the first quarter. Earlier this month, GM's chairman, Rick Wagoner, said he hopes that profits from cars in North America will recover to $1.4 billion this year, with the European business breaking even and the losses in South America narrowing. At the star performer—GM's car business in the Asia-Pacific region, where net profits tripled last year to $577m—they are expected to rise by some 40% this year, thanks largely to GM's strong position in China.

Mr Wagoner dismisses fears that China will turn out to be a large-scale version of the Brazilian market, which collapsed in 1997 just as the global car industry decided to set up camp there. “China is not another Brazil,” he says. “If new capacity there is not fully used in year one it will be used in year three. And there's scope for consolidation, to take stakes in some of the 200 small carmakers that have a third of the market.”

What is really grabbing the attention of the analysts is the fact that GM is making progress across a broad front. Financially, it is easing the burden of its pension liabilities and making moves to staunch the inflation of health-care costs; it has plenty of new products in the pipeline; it is catching up on Japanese standards in terms of both productivity and quality; and morale has picked up, helped by the remarkable recovery of the flagship Cadillac brand. This has “stopped the slide and gained momentum,” says Mark LaNeve, the division's general manager. That opinion is echoed even by Steve Girsky, an industry analyst at Morgan Stanley and a long-time critic of the company.

Until new designs were launched four years ago, Cadillac had been in steady decline. Now GM's North American boss, Gary Cowger, gleefully points out that the luxury division's sales are back up to 216,000, a level not seen since 1996—before European and Japanese rivals grabbed GM's market share. The company now plans to apply the same formula to turn around its mass-market brands, such as Chevrolet and Pontiac. One key weapon, according to Larry Burns, who runs GM's R&D, is shorter lead times for new products—which have come down by 50% (to 25 months) since the late 1990s.

What a difference a year makes

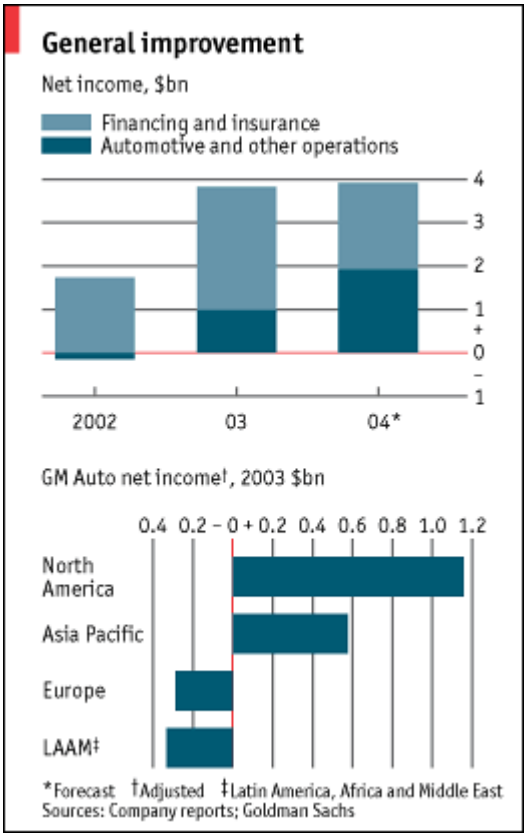
“What's good for General Motors is good for the country,” famously said the company's president almost 50 years ago. But what was good for America in the 1990s was not good for GM. In 1992 the company was minutes away from declaring bankruptcy, and it spent the next ten years in a grinding struggle to pull back from the brink. A disastrous strike in 1998, which cost GM $2 billion in lost profits, seemed to set the seal on its demise.

But Jack Smith, who became chief executive and then chairman in the firm's darkest hour in the early 1990s, patiently set about establishing the means for GM's recovery. He built a youngish executive team around his protégé Mr Wagoner, who succeeded him as chairman last May. Mr Wagoner duly brought in Bob Lutz, a 70-year-old industry veteran with a glittering career at Ford, Chrysler and BMW, in both America and Europe, to shake things up.

The result has been an overhaul of its cautious, cumbersome committee-style management. Decisions on everything from new designs and new products to plant closures are now taken rapidly and efficiently. There is a feeling of confidence around, so much so that Mr Wagoner is forecasting an increase in overall earnings in 2004, with the target of a further 40% rise by “the middle of the decade”.

Yet this time last year GM's future still looked grim. Its pensions and health-care burden appeared oppressive for an organisation with 2.4 retired workers for every current employee. The deal to sell Hughes Electronics was being blocked by federal regulators,

depriving GM of the cash it sorely needed. The prospect of difficult negotiations on pay and other benefits with the United Auto Workers (UAW) union was looming, and European and Japanese competitors were driving straight into the last redoubt of Detroit's Big Three automotive firms—the high-margin sport-utility vehicles (SUVs) and pick-ups, the only part of the market where they made profits.



Even today all is not yet rosy for GM. It faces increasing competition across the board from the Japanese, South Koreans and Europeans, in both cars and light trucks. And some of the turnaround due this year is down to financial engineering rather than the old-fashioned sort of engineering more usually associated with car companies.

Thanks to a peculiarity in America's accounting rules, GM's solution to its most public financial problem—a massive shortfall in its pension fund, amounting to $19.3 billion at the end of 2002—will enable the firm to increase its profits. GM filled the gaping hole last year by contributing $18.5 billion to the fund, most of it raised on the bond markets. In the unreal world of American pension-accounting, firms are allowed to assume a flattering rate of return on their pension-scheme assets. And the expected (rather than the actual) return is recorded as income in the profit and loss account. As GM's expected rate of return of 9% is higher than the rate of interest on its bonds, its nifty piece of balance-sheet management—replacing unfunded pension liabilities with long-term financial debt—will increase its profits by around $500m in 2004.

Summer's Solstice?

And yet something more profound than clever financial shuffling has been occurring at GM. This was obvious at this year's North American International Auto Show in Detroit earlier this month. Over the past decade, the show has provided a ringside seat to watch Motown's steady evolution, as it virtually abandoned passenger cars to foreign rivals in favour of big (and highly profitable) trucks. But at this year's show it was Japan's three biggest carmakers that rolled out the pick-ups and SUVs, while in the far corner of the sprawling auditorium the centrepiece of GM's stand was a trio of small cars: the Pontiac Solstice roadster, the Saturn Curve and the Chevrolet Nomad. The three looked distinctly out of place alongside the likes of the massive Chevrolet Suburban and Cadillac Escalade SUVs. Yet they are clear signs that GM has finally decided that the biggest risk of all is not to take any risk.

It has been conventional wisdom to compare GM to a supertanker, and a listing one at that. Long the biggest competitor, it nevertheless seemed oblivious to the global forces reshaping the industry. Its ageing product line lacked excitement and its market share crumbled. So when the Solstice first appeared as a “concept car” at the Detroit show in January 2002, it created plenty of buzz. The little two-seater was small, sleek and sporty, the last thing anyone expected from GM, where consensus generally overruled flair.

Solstice had even taken Mr Lutz by surprise when he had first seen the prototype a month before the 2002 show. But it was precisely what he was looking for, and he was determined that it should not get stuck in a warehouse with all the other examples of grand designs that never got built. Solstice had to be put into production.

A decade ago, that would not have happened. Even the GM of 1999 would have abandoned the project in a hurry, or delivered a production vehicle that had little in common with the concept. An intricate network of autonomous designers and no fewer than ten engineering centres conspired to stretch out the product-development process to four, five and even six years. An industry rule of thumb suggests that a million dollars should be added to the cost of a project for each extra day it spends in development.

Solstice shows a very different system is at work inside GM, one where the North American engineering operations have been consolidated into a single entity housed in a grand new tower at the General Motors Technical Centre in suburban Detroit. The marketing managers, who blithely tinker with designs

to reflect the results of their latest consumer clinics, were kept at a distance while the production version of the Solstice was being prepared. They were not allowed to second-guess Ed Welburn, GM's new design director. And with his booming voice and macho presence, Mr Lutz made it clear that the Solstice would look and drive as much as possible like the original concept car—but it would also stick to the original target, a starting price of under $20,000.

Motoring journalists will have to wait until later this year to test the car's road manners. But the vehicle that reappeared in Detroit this January suggests GM is comfortably adapting to a new era of disciplined management.

The cars now standing on one platform

Since it launched its patriotically themed “Keep America Rolling” campaign in the weeks after 9/11, GM has shelled out billions in the form of rebates, low-interest loans and other incentives to lure buyers into its showrooms. And even then, the company could not quite reach its target market share of 29%. At its peak, the Chevrolet division alone held nearly that much of the American market. In the early 1960s, GM as a whole built more than one out of every two cars sold in the country.

But in the days when GM ruled the road there were only 30 car models around, half of them made by GM. Today there are no fewer than 600 different models on the market, says Mark Hogan, a GM product-development manager. He points out that car companies today can no longer count on huge production runs (like those of the legendary Chevrolet Impala, which rolled out half a million examples a year).

So GM has had to reinvent itself to cope with a market that has not merely been segmented but turned into an ever-changing kaleidoscope, in which a successful single model sells around 300,000 vehicles. The trick is to make different models using the same underpinnings of parts unseen by the consumer. Japanese producers and Volkswagen in Europe have long been expert at this, and GM has at last got the message. It now has five such “platforms” or “vehicle architectures” on which to build different models for local markets.

It has also done more basic factory-level improvements in order to cut costs. According to the Harbour Report, the industry's reference for productivity numbers, GM has been steadily closing the gap with its Japanese rivals. Harbour says the carmaker managed a 7.4% improvement in assembly-plant productivity in 2002, part of a steady pattern that has seen its efficiency rise by 22% over five years. It is “on the heels of some of the best,” says Ron Harbour, the firm's president, which is all the more notable since the company was long the Harbour Report's productivity laggard. The laggards now are Ford and Chrysler, and that is allowing GM to take control of the discounting game.

Things should get even better from now on, thanks to a helping hand from the UAW. Union and management spent years locked in a *danse macabre*, seemingly committed to mutual destruction. But they were both shocked by the costly six-week strike in 1998, and after it both sides were determined to change.

One instrument of change was Mr Cowger, who was brought back from Europe because he knew how to get along with organised labour. Contract talks last summer were stunningly civil. Although GM did not get the relief it sought from surging health-care costs, the union offered plenty of other concessions that will keep productivity rising and overall labour costs in check.

That will make it easier for GM to implement the grand global-manufacturing strategy that it has begun to put in place in some of its newest overseas facilities, in cities such as Gliwice and Shanghai. Its $10,000 entry-level small cars designed to get college students hooked on GM products will actually be made by Daewoo and imported to America to be sold with a Chevrolet badge.

Under Mr Wagoner and his predecessor, Mr Smith, GM has taken stakes in a number of foreign carmakers such as Daewoo, Fiat, Fuji (the maker of the Subaru) and Suzuki. These links are producing a wider range of technology and product design, and they have allowed GM to zoom ahead in the Asia-Pacific region, a trick it is hoping to repeat in Europe by sharing parts such as engines and gearboxes with Fiat. Though the latter's troubles may stop GM from increasing its 10% stake in the Italian company, Mr Devine is convinced that the co-operation, leading soon to a shared basic design for a small car, is paying off. Between them, the companies in this global confederation account for 25% of the 60m cars that will be sold in the world this year. “We're learning how to use size as a competitive advantage,” says Mr Wagoner.

Productivity is just one measure of what comes out of a factory, though. Quality, stresses David Cole, chairman of Ann Arbor's Centre for Automotive Research in Michigan, “is just the price of admission”. In car-savvy America, where consumers can call up any conceivable statistic on the internet, even the most minor defects are unacceptable. These days, Cadillac's biggest Asian competitor, the Lexus, has less than one flaw for every two vehicles. But its parent company, Toyota, has suffered some unexpected declines in its quality, according to the latest Initial Quality Survey from J. D. Power and Associates, a benchmarker for the industry.

Morgan Stanley's Mr Girsky believes this provides the Motor City's manufacturers with some real opportunities. But customer perceptions lag improvements in quality. Getting the message across won't be easy. One cute marketing trick is to offer free 24-hour test drives. So far 500,000 of these have produced 170,000 sales, according to Mr Cowger.

It took 20 years for Detroit's reputation to sink to its lowest point. GM is hoping that it will take a lot less time to regain the glitz and glamour of its good old days.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Parmalat

Skimming off the cream

Jan 22nd 2004
From The Economist print edition

EPA

To their embarrassment, some of the world's biggest banks made plenty of profits from Parmalat

A DIVERTING sideshow is going on in Italy. On January 19th Matteo Arpe, chief executive of Capitalia, the country's fourth-largest bank, announced a pay-back programme for retail investors who, upon its bankers' advice, bought bonds in Parmalat, the insolvent and scandal-ridden dairy group, among other smaller, now-bankrupt companies. Capitalia estimates the buy-back of defaulted bonds will cost it some €60m ($76m).

Yet while Italy's banks blushingly try to redeem themselves, their big international counterparts, especially American ones, are trying as hard as they can to keep their names out of the Parmalat affair. Try as they might, however, a new line of investigation into their dealings with Parmalat opens up by the week. On January 21st Italian police searched the Milan offices of Morgan Stanley.

It is not yet clear whether big international banks, in theory still reeling from the ease with which they were duped by Enron and other financial frauds, will suffer the same sort of reputational damage that dogged Wall Street after the stockmarket bubble burst. It is, after all, less than a year since J.P. Morgan, Citigroup and Merrill Lynch coughed up $135m, $101m and $80m respectively, to settle charges over their role in Enron's fraud (albeit without admitting guilt). But what becomes abundantly clear as more becomes known about this latest scandal is that banks will always succumb to the temptation of fat fees today—and leave the awkward questions for later.

Certainly, they will not emerge from Parmalat's wreckage unscathed financially, lured as they were by fat profits into making sloppy loans and giving the company the use of their balance sheet in other ways. Their total exposure to Parmalat was perhaps $5 billion, though it may be more.

Nearly 30 international banks have banded together under Citigroup's leadership to seek recompense from Enrico Bondi, the acting boss of Parmalat installed to keep the group operating and perhaps bring it out of bankruptcy. Among the worst hit of these is Bank of America, with a $274m exposure at the end of 2003 in loans and derivatives. The blow to Citigroup was even bigger. It

reported a $544m after-tax exposure in 2003 due to Parmalat-related credit and trading losses, of which almost half was written off entirely—a hefty number, though not much compared with the $17.85 billion which the bank made last year.

Worse may be to come, however. The vast bulk of the more than $10 billion in public and private debt placed by Parmalat since 1997 was arranged by big banks, including Bank of America, Citigroup, Morgan Stanley and Deutsche Bank. The Securities and Exchange Commission (SEC), America's main securities regulator, is examining whether American banks deliberately ignored irregularities in Parmalat's finances when they sold Parmalat bonds to (mainly American) investors.

Certainly, banks played a role in helping Parmalat arrange elaborate financial structures, reminiscent of Enron's gymnastics. These offshore vehicles and contracts allowed Parmalat to shift money around and to raise cash in ways that made it almost impossible for outsiders to understand what was going on.

One structure in particular, a Citigroup entity registered in Delaware and called *Buconero*—Italian for “black hole”—was allegedly used by Parmalat to conceal borrowings and to conduct a massive fraud. This has drawn fire—and a class-action lawsuit—from investors. Citigroup has said it regrets the choice of the name and denies any wrongdoing.

Milked

Italian banks' exposure to Parmalat and Parmatour

	Estimated exposure, €m	Potential loss, €m
Capitalia	484	290
Banca Intesa	360	216
Sanpaolo	303	182
MPS	183	110
UniCredit Banca Mobiliare	162	97
ABN Amro	160	96
B.P. Lodi	126	76
BNL	120	72
BPU	105	63
B.P. Emilia	70	42
Credem	53	32
Banca Antonveneta	41	25
BPVN	35	21
Banca Lombarda	35	21
Banca Etruria	20	12
B.P. Milano	9	5
Total	2,266	1,360

Source: Industry sources

Then there are complex derivatives, another juicy investment-banking niche. Parmalat seems to have used a lot of these. One type, called “self-referenced credit-linked notes” (CLNs), in which Parmalat invested $30m, was essentially an insurance policy written on itself. These particular notes were issued by a vehicle set up by Merrill Lynch in 1999. The effect of such complex instruments was to paint a flattering picture of Parmalat's financial health.

All these issues go to the heart of the dilemma facing big investment banks. Even if they suspect that a client such as Parmalat is using offshore vehicles or derivatives in a questionable way, this business is extremely lucrative for the banks themselves. Rather than refuse it, they have tended to pocket the fees while drawing up contracts designed to limit their own legal liability if trouble hits. Yet in doing so, they implicitly acknowledge that there may be something not quite right. Not only does this expose them to reputational risks but, despite such contracts, it also puts them in legal jeopardy, especially in wrangles over assets in a bankruptcy proceeding.

That is because by far the biggest losers from the Parmalat fraud could be the bondholders, who have seven times more debt than the banks. Given the cosiness between Italian politicians and banks, bondholders fret that local outfits will get preferential treatment in the restructuring. They also worry that a consortium of banks led by Citigroup will grab a bigger share of any assets than it deserves.

The new Italian bankruptcy law rushed through Parliament on December 23rd has not mollified these concerns. “The Italian system is incredibly opaque and non-consultative,” says Evan Flaschen of Bingham McCutchen, a law firm advising Parmalat's largest bondholder group.

That argument will roll on for months. But might international banks learn something in the meantime from Italian banks' frantic efforts to regain investors' trust? They certainly need to do something to restore their reputations, so deep are they mired in the scandal. Capitalia has more troubles than most.

The bank has an estimated €484m in exposure to Parmalat. And Cesare Geronzi, the bank's chairman, was accused by Calisto Tanzi, the former boss of Parmalat and now an inmate of San Vittorio prison in Milan, of forcing Mr Tanzi to buy several companies at over-inflated prices. Mr Tanzi claims that Mr Geronzi made him overpay for Eurolat, a milk company he bought for 650 billion lire ($336m) in 1999, explaining he could not refuse because of his close relationship with Banca di Roma, as Capitalia was called at the time. Mr Geronzi is also under investigation in a probe into the bankruptcy of Cirio, another Italian food firm.

Italian banks' lending exposure to Parmalat is an estimated €2.3 billion, about half the lending exposure

of all banks. While there is little systemic risk for Italy's banks as a whole—the loans are spread among many institutions—there will be a shake-up of the industry, thinks Davide Serra, an analyst at Morgan Stanley. He predicts that six or seven months of the industry's earnings will be wiped out, increasing pressure on some of Italy's weaker houses, such as Capitalia and Banca Nazionale del Lavoro.

Tighter supervision might also force them in the same direction. Giulio Tremonti, Italy's finance minister, proposes merging four financial regulators into one super-regulator or, failing that, uniting Consob, the toothless securities-market regulator, the Bank of Italy, the banks' watchdog, and the antitrust authority. Mr Tremonti's proposals are an attack on Antonio Fazio, the head of the Bank of Italy, who has repeatedly vetoed takeover attempts of Italian banks by foreigners as well as big domestic bank mergers.

But the real heat is on Mr Geronzi. If Mr Tanzi's allegations are true, his position at the helm of Capitalia looks indefensible. Yet when Silvio Berlusconi's Fininvest empire was in trouble some ten years ago, Mr Geronzi was one of the only bankers prepared to help today's prime minister. Say what you will about Italy, it is a place where favours count.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Italian corporate bonds

Fashion victims

Jan 22nd 2004 | ROME
From The Economist print edition

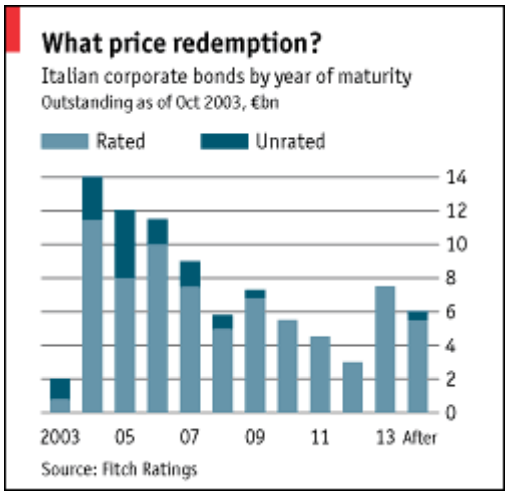
Trouble for the Italian bond market

IN FINANCE as in fashion, Italians are suckers for the *bella figura* (looking good). So it was no surprise that investors wanting higher returns than the vanishing yields available on government bonds jumped into corporate bonds in the late 1990s. They looked attractive. The collapse of Parmalat, and a rash of other defaults, have woken Italians up to the fact that buying corporate bonds is a little riskier than buying a Prada handbag.

When Parmalat fell, it took with it the savings of tens of thousands of Italian retail investors who held the company's bonds. But it is by no means the first or the only company to run into trouble. Just over a year before the dairy group's debacle, Cirio, another Italian food group, had also defaulted. On January 20th, investors in Finmatica, a software firm, learnt that the chairman, three other members of the board and three statutory auditors had been placed under investigation for, among other things, making misleading statements about its health. The price of its bonds fell sharply. Italtractor, an engineering firm, has also technically defaulted, and the company wants to extend the maturity of bonds that it was supposed to have redeemed on January 22nd by four years.

Investors are understandably now looking more sceptically at corporate debt. Although Telecom Italia, the country's main phone operator, sold €3 billion of bonds on January 13th, its ability to place its debt at a reasonable rate said more about the strength of the telecoms group than the health of the market. Spreads of riskier domestic corporate bonds over government debt have climbed by a couple of percentage points at least in the weeks following Parmalat's collapse.

This comes at an awkward time for Italy's companies, which must refinance a lot of debt this year. Fiat, a troubled car-maker, has to repay at least €1 billion to bondholders this year, and possibly another €1.8 billion, depending on the decision of investors in bonds it has issued that are exchangeable into shares in General Motors. Fiat's bonds are part of about €14 billion of Italian corporate bonds that will mature this year and some €12 billion next year, many of these unrated (see chart).



Higher costs on their new debt is the price that corporate Italy will have to pay, says Carlo Pinardi at Bocconi university, for the breakdown of trust. This will take a while to rebuild, in part because the banks that sold the bonds have not covered themselves in glory. Many banks had cut lending to companies in which they encouraged the public to invest. A badly educated Italian public woefully underestimated the risk.

There is, however, a silver lining. Healthy Italian companies are not shut out of the market. All that has happened, says Marco Cecchi de Rossi, of Fitch Italia, a rating agency, is that investors have become more discerning about risk. But the example of America, where investors have recently been piling into almost anything with a sniff of yield, does not indicate that this discernment will be long-lived.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Banking regulation

Hall of fame

Jan 22nd 2004 | NEW YORK
From The Economist print edition

A new case tests who regulates America's banks

AP

ELIOT SPITZER likes to recall how, back in his days at law school, he was appalled by the movement to shift power from the federal government to the states. That was before he was a state-government official. Using his role as New York's attorney-general at a time when financial malfeasance has been rife, he has bludgeoned his way into a pivotal role in the regulation of one financial sector after another—first investment banking, then mutual funds. Whatever his motivation, Mr Spitzer has done a fine job illustrating the structural anarchy in America's supervision of its financial institutions. On January 15th he set his sights on an even more powerful industry, and one, moreover, whose regulation is positively Byzantine: America's commercial banks

The might of America's banks is in stark contrast to the apparent insignificance of the case that Mr Spitzer is using in his opening skirmish, which would normally have been of scant interest even to a local lawyer. In 1974, Richard Hall took out a mortgage for a small home in New York from the improbably named Mechanics Exchange Savings Bank. As is common in America, the mortgage was transferred several times and ended up with a bank in Tennessee that proved woefully inept. Mr Hall was not notified when he had paid off the loan, and the bank landed him with lots of apparently ludicrous extra charges. Mr Hall did what presumably anyone with a financial gripe is now doing in New York: he made his way to Mr Spitzer.

The complaint could not have arrived at a more perfect time for Mr Spitzer—or a more awkward one for America's banks, which are enjoying bumper profits. On January 20th, Citigroup announced that it had made net profits last year of $17.85 billion—more than any other company in history. As a group, American banks have made perhaps $300 billion last year, a third of all corporate profits.

Oddly, this huge and critically important industry is overseen by an assortment of regulators whose overlapping responsibilities are understood by almost no one. Local banks are overseen by the Federal Deposit Insurance Corporation and state regulators. Some of the biggest banks, and all bank holding companies, are also supervised by states but in conjunction with the local branches of the Federal Reserve. Those that are not fall under the purview of the Comptroller of the Currency, a branch of the Treasury Department.

Not surprisingly, perhaps, anomalies abound. Citigroup, America's and the world's single most-global financial institution, is regulated by the Comptroller of the Currency. While J.P. Morgan Chase, America's second-biggest bank, with headquarters only a few hundred metres away on Park Avenue, is regulated by state regulators and the New York Fed.

These inconsistencies arise partly because America did not really have national banks in the past. Laws limited even the largest institutions to individual states, and supervision was generally local. But the laws were changed in the mid-1990s, and banks have merged across state boundaries at a furious rate.

State lawmakers have responded by trying to regulate a wide range of activities of the increasingly remote institutions operating within their borders. Limits on ATM fees and “predatory” lending have been particular concerns. Legal battles about these issues have been waged over the past two years in California and Georgia. But courts ruled these activities were the responsibility of the Comptroller of the

Currency, not the states.

To quell future challenges over the last year, the Comptroller of the Currency has codified what it claims to be 140 years of banking law. Put simply, the new rules, issued officially at the beginning of this year, told the states to keep out of the regulation of national banks. State officials were apoplectic. Mr Spitzer, who seems never to have seen a piece of turf that he did not want to make his own, vowed to challenge them. Thus did the fortunate Mr Hall find his champion, and the First Horizon Home Loan Corporation, a subsidiary of First Tennessee Bank, find itself charged under New York law with unlawful collection and deceptive business practices.

Mr Spitzer's move drew an immediate rebuke. John Hawke, the Comptroller of the Currency, called Mr Spitzer's action “preposterous” and derided it as “political grandstanding”. He has a point. For a rapidly consolidating banking industry, national regulation is clearly more efficient in some ways than a hodgepodge of local rules; and the Comptroller's office has a vast staff to resolve consumer complaints.

Yet by excluding New York's own regulatory apparatus, the Comptroller has removed an entire layer of consumer protection, says Diana Taylor, New York's superintendent of banks. This has proved important for all manner of subtle charges for mortgages, money withdrawal, insurance on loans and, inevitably, high-interest loans. Local laws are, moreover, responsive to a broader constituency than the Comptroller's office, which is responsible for banks, not their customers. These thoughts are not merely academic. Congress will probably hold hearings on the subject next week. And Mr Spitzer's case, or one like it, says Ms Taylor, is inevitably headed to the Supreme Court.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Japanese shares

On the edge

Jan 22nd 2004 | TOKYO
From The Economist print edition

Insanity rules in Japan's stockmarket

Get article background

TAKE a 100-for-one stock split, mix in a few mishaps, and stir in rampant speculation. The result for Edge, a young internet company (until recently, rather more aptly named Livin' on the Edge), has been a spectacular rise in its shares, which rose by the daily limit allowed by the Tokyo Stock Exchange (TSE) for 15 days on the trot, before falling on January 21st, a day short of the record.

At its peak, Edge's market capitalisation was almost ¥1 trillion ($9.3 billion), not bad for a company with only ¥11 billion in sales last year and 359 employees. Edge's current market capitalisation is still bigger than Japan Airlines, the country's top airline, which racked up ¥2 trillion in sales last year.

Edge's giddy rise started after its stock split last month. It turned out that delivery of the new shares would be delayed, as happens so often in Japan, and would not be completed until February 20th. This created a temporary imbalance between supply and demand, made worse when a securities house accidentally sold short some 10,000 old Edge shares, and was left scrambling to buy them back. Sniffing an easy profit, speculators placed huge orders, in the hope of mopping up any old shares left in the market, and prompting an unusual call from the TSE for calm.

The craziness, say brokers, is reminiscent of the internet bubble, when stocks soared to great heights only to come crashing back down months later. The most notorious example, Softbank, an internet incubator, became Japan's third-biggest company by market capitalisation when it hit ¥20 trillon in February 2000, only to have 98% of its value wiped out by the end of 2002.

It is not just high-tech companies that have shot up. Last year, the government created what some dub a “moral hazard” bubble after pouring ¥2 trillion into Resona, the fifth-largest bank, which found itself short of capital last May. The bail-out, perceived by investors as a message that the government would not let Japan's top banks or their worst big borrowers, fail, sent the stock price of weak companies soaring in the months following the bail-out, thanks largely to the activities of individual traders who buy securities with borrowed money.

Now the unjustified is becoming the absurd, though this still passes for normal in Japan's stockmarket. Though Edge's run has been halted for now, its old shares are still five times pricier than its new ones. Brokers warn that speculators could cause more havoc before the prices of the old and new shares are unified on February 24th. Punters are already piling into New Deal, a scandal-ridden company with a dud music-distribution business, which is planning a 1,000-for-one stock split next month.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Currencies

Talk is cheap

Jan 22nd 2004
From The Economist print edition

Bumps on the road to a weaker dollar

Get article background

AT LAST, Jean-Claude Trichet, the president of the European Central Bank (ECB), is letting the markets know that he is worried about a stronger euro. On January 12th he launched traders on a selling-spree of Europe's currency by describing the single currency's rise as “unwelcome” and “brutal”—which it obviously is for Europe, since a stronger currency threatens its budding economic recovery. Together with comments from others in Europe's financial hierarchy (a departure from the ECB's more relaxed stance), Mr Trichet's comments halted the euro's rapid march towards $1.30 and caused it to fall by about 4% a week later.

The disquiet of European policy-makers is understandable. Europe has shouldered much of the adjustment in the dollar, for Asian central banks have spent many billions of dollars in an attempt to halt their currencies' rise against the greenback. If Japan and China, whose currency is pegged to the dollar, continue their stubborn ways, the dollar will need to fall even more against the euro to cure America's imbalances. Mr Trichet's broadside suggests that Europe's central bankers are beginning to find this unacceptable.

Alas, currency markets rarely respond to words alone. Indeed, when European finance ministers joined Mr Trichet's rebuke to the markets, traders sent the currency soaring again. Though ministers wrung their hands over “volatility” in the markets, their half-hearted words failed to convince traders that any action was planned.

The ECB could, of course, cut interest rates, but it has seemed more concerned with fighting inflation—which to most economists seems like fighting the last war—than reducing pressure on the euro or spurring growth. The ECB could also intervene in the foreign-exchange markets, but in the long term, such efforts are likely to be fruitless unless the Americans are in favour. They aren't.

Still, Mr Trichet and his colleagues at least made the markets pause for thought in what had seemed a one-way bet. Almost everyone had been bearish about the dollar's prospects, for the logic behind its fall has seemed impeccable. America's oft-lamented twin deficits, those of its government budget and its current account, which need to be corrected by a weaker dollar, have shown every sign of getting worse, not better, and foreigners now need to lend America some $45 billion a month to allow the country to maintain its spending habits. Ergo, the dollar must fall.

Two recent developments have, however, questioned this logic. The first was that on January 14th, the Commerce Department announced that America's trade deficit, at $38 billion in November, was better than expected. The fall in imports was especially welcome, given that the weaker dollar had previously failed to dent Americans' predilection for foreign goods. Europe's trade surplus also fell in November. America's current-account deficit, at 5% of GDP, is still huge, and one month's statistics scarcely constitute a trend, but it is at least possible that the fall in the dollar is finally having some effect.

The second factor that may sustain the dollar, at least for now, is that foreign investors seem to have been more enthusiastic about buying American assets. On January 16th, the government's flow-of-funds numbers showed that overseas investors had bought $83 billion-worth of American securities in November—nearly twice the monthly current-account deficit. The pleasing thing for that endangered species, the dollar bull, is that it was not just Asian central banks, the main foreign buyers in recent months, who been snaffling up Treasuries. Private investors were more eager buyers of Treasuries, shares and corporate debt than they had been in months, perhaps encouraged by robust economic

growth.

But America still needs to attract a lot of money. And the ECB has precious few weapons in its armoury. Mr Trichet will be hoping that the G7 summit in early February will be sympathetic to his cause. But it is difficult to see why any of Europe's trading partners will be overly concerned.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economics focus

Canyon or mirage?

Jan 22nd 2004
From The Economist print edition

A new paper questions the notion of a worsening digital divide between rich and poor

THAT there are more telephones, computers and internet connections in rich countries than there are in poor ones is obvious. There are also more cars, televisions and air-conditioners. But the difference in the availability of information and communication technologies (ICTs) is the focus of particular concern among policymakers, academics and non-governmental organisations. Such technology, it is generally agreed, boosts productivity, though how quickly and by how much is the subject of much debate. The far wider availability of ICTs in rich countries, goes the argument, will therefore enable the rich to get richer, while the poor are left behind. In short, not only is there a worrying "digital divide" between rich and poor, the divide is widening—with ominous consequences.

These beliefs are widely held. But a new paper* by two economists at the World Bank, Carsten Fink and Charles Kenny, questions the logic of this argument and highlights the woolly thinking that pervades the digital-divide discussion. The authors conclude that the divide's size and importance have been overstated, and that current trends suggest that it is actually shrinking, not growing—which means policies designed to "bridge the digital divide" may need rethinking.

For a start, Messrs Fink and Kenny observe, the term "digital divide" came to prominence "more for its alliterative potential than for its inherent terminological exactitude". It is used in at least four distinct ways, and two in particular: to describe the gap in access to ICTs between rich and poor countries, and the resulting gap in usage. The digital divide is almost always described in terms of the difference in the number of telephones, internet users or computers per head in rich and poor countries. For example, there are more telephones than people in most developed countries, compared with around three telephones per 100 people in the developing world.

While the gap as defined using these per-head measures looks enormous, the growth rates tell a different story. Over the past 25 years, telephone penetration has been increasing faster in low and middle-income countries than in high-income countries, which has not been surprising given the market saturation in rich countries. But the same is also true of internet usage, which grew by around 50% per year in high-income countries in the late 1990s, compared with 100% per year in low and middle-income countries. The rich are ahead, but the poor are catching up fast. So much for the "widening digital divide" decried by such organisations as the United Nations Development Programme. The most striking feature of the per-head divide in access to ICTS, conclude Messrs Fink and Kenny, "is not how large it is, but how rapidly it is closing."

Wired in Wuhan

But such per-head figures may not even be the right way to measure the divide. You would expect poor countries to have fewer telephones and computers per head, simply because they are poorer. And phones and computers are routinely shared between many users in developing countries. Mobile phones are often rented out by the call, and cybercafés provide internet access to people who could otherwise not afford it. One alternative measure, suggest the paper's authors, is per-income availability of ICTs. The number of phones and internet users per dollar of GDP provides a measure of the relative importance attached to ICTs. On this measure, the digital divide becomes a "digital leapfrog", as low- and middle-income countries jump ahead of rich ones. This finding is even more striking, say the authors, given that income inequality between the developing and developed world seems to have widened slightly. "Even though developing countries have fallen behind economically over the past decades, they managed to catch up digitally," they note.

Does that mean there is nothing to worry about? Not necessarily. One worry is that ICTs might have less impact on productivity in poor countries than in rich countries because of lower adoption levels. It is possible, for example, that a certain threshold level of adoption is required before the productivity benefits of ICTs kick in. But even if this is true, the high growth rates suggest that there are perceived benefits to adopting ICTs in any case, even if productivity benefits have yet to materialise, so that the threshold will eventually be reached.

Another worry is that the adoption of ICTs within poor countries may be hugely unequal, and limited to a relatively affluent minority, so that the digital divide within countries may grow even as the digital divide between countries shrinks. Moreover, rich countries with high penetration of ICTs may be more likely to do business online with other such countries, at the expense of poor countries. Well, perhaps, but it seems far more likely that access to ICTs will, overall, enlarge poor countries' trading opportunities. And as the authors suggest, growing access to ICTs will improve their plight.

All this has important ramifications for policymakers. There is no doubt that the adoption of ICTs plays a big role in development. But it is a mistake to place too much emphasis on “bridging the digital divide” by trying to narrow the per-head divide in access. For one thing, the divide is narrowing on its own. More important, when it comes to determining the best use of international aid, money given to narrowing the divide might be better spent elsewhere. In many developing countries, people face far more important challenges than the lack of internet access, namely lack of access to water, food, medical treatment and education. For them, the digital divide is a symptom, rather than the cause, of wider inequality.

---

* “W(h)ither the digital divide?” *Info, The journal of policy, regulation and strategy for telecommunications* volume 5, number 6 (2003)

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Cancer modelling

Malignant maths

Jan 22nd 2004
From The Economist print edition

Mathematical models aid the understanding of cancer

PRACTITIONERS of so-called hard sciences—those backed up by the mathematical rigour of formulae and equations—have traditionally looked down on the squishy end of research. That disdain has evaporated a bit over recent years, as government money has migrated from physics to biology and medicine. But it is disappearing as biologists show that they can be just as quantitative as their hard-edged colleagues.

And one example is in the field of cancer research. According to Hans Othmer, a mathematician at the University of Minnesota, in Minneapolis, who has written a review of the subject forthcoming in the *Journal of Mathematical Biology*, a rapid growth in the understanding of the microscopic processes behind cancer is allowing useful mathematical models of the disease to be developed. Indeed, the field is booming, which is why the ponderously named *Discrete and Continuous Dynamical Systems—Series B*, another scientific journal, is devoting a special issue to the subject in February.

One paper in this special issue, by Zvia Agur and her colleagues at the Institute for Medical BioMathematics, in Bene Ataroth, Israel, presents a model that attempts to describe how angiogenesis—the process by which a tumour creates its own blood vessels—works.

When a tumour first develops from a cell whose genes have mutated in ways which cause that cell to reproduce frantically, its growth is limited to about a millimetre across. This is because no blood vessels penetrate the tumour, and therefore cells deep within it are not able to get nutrients or oxygen.

Bloody essential

Tumours of this size pose little threat to a person's health. Indeed, many tumours stay this small. But in some, further mutations cause the production of chemicals called growth factors, which stimulate the formation of blood vessels. This process is dangerous for the individual not only because it allows tumours to grow in size, but also because cancerous cells can now enter the bloodstream, travel around the body, lodge in other places, and then continue to grow. Such dispersion results in the formation of secondary tumours, known as metastases, which are what kill the patient in many cases.

Dr Agur examined magnetic-resonance images of tumours undergoing angiogenesis, and then set up a

system of differential equations to simulate what she saw. Differential equations relate the rate of change of a variable (for example, the amount of growth factor being produced) to its current value and, in some cases, its past values. And they are the staple of virtually all mathematical models of cancer, which usually consist of a set of “simultaneous” differential equations, one per variable, whose results feed into one another. Solving such systems is difficult; indeed, precise solutions can only rarely be found. Instead, researchers rely on numerical simulations, or else analytically describe the rough form that solutions might take.

In Dr Agur's equations, the variables are the number of cells in a tumour, the concentration of the angiogenetic growth factors within it and the volume of the blood vessels supporting it. The result was the discovery that there are circumstances in which a tumour oscillates in size, instead of growing steadily. In other words, it is contained. If such circumstances could be replicated in reality, it would be a powerful way of controlling tumour growth.

Stemming angiogenesis would stop a tumour in its tracks. But if it is too late for that, different methods are called for. In the past, there were only three ways of treating cancer. The first was to remove the cancerous cells by surgery. The second was to treat them with chemicals that would inhibit their growth, or kill them off. The third was to blast them with ionising radiation, or with heat.

Helping those who help themselves

In the past few years, however, a fourth method has come into being. This is to stimulate the immune system. Because cancer cells contain mutations, they produce proteins that appear “foreign” to the immune system. That system is designed to attack such cells—and, indeed, it often does so of its own accord. But sometimes it needs a helping hand, in the form of an external stimulus, such as a drug.

Because immunotherapy is still in its infancy, its potential, and the behaviour of cancerous cells when they interact with the immune system, are not that well understood. This makes the field particularly fertile ground for mathematical modelling. In another of the special-issue papers, Denise Kirschner of the University of Michigan, in Ann Arbor, describes her investigations into how a novel treatment, known as “small interfering RNA” (siRNA) therapy might suppress the action of a molecule called “transforming growth factor beta” (TGF-beta), which large tumours use to elude the immune system.

The equations of Dr Kirschner's model describe four quantities: the number of immune-system “effector cells” (those that combat tumours), the number of tumour cells, the amount of interleukin-2 (a protein that enhances the body's ability to fight cancer), and an additional variable to account for the effects of TGF-beta.

At the moment siRNA therapy has been tried only in a test tube, so Dr Kirschner's simulation may provide a quick way of deciding whether it is worth pursuing actual animal experiments. According to her paper, it looks promising. In the model, a daily dose of siRNA over the course of 11 successive days succeeded in counteracting the effects of TGF-beta, and so allowed the immune system to bring the tumour under control, although it did not succeed in eliminating the tumour entirely.

Back to basics

Both Dr Agur's and Dr Kirschner's work look promising. Not all of the mathematical models discussed in the special issue are as abstract, though. Pep Charusanti and his colleagues at the University of California, Los Angeles, looked into how a drug called Gleevec acts against chronic myeloid leukaemia.

Gleevec works by preventing the phosphorylation of a protein called Bcr-Abl, which is crucial to the development of the cancer. Phosphorylation is an energy-transfer process, the energy in question being transferred from molecules known as ATP, which are the end-result of the process of respiration. Because the model focuses on a specific cancer, and a specific drug, it is more detailed than any of the others. It goes back to basic equations of “biochemical kinetics”, the study of how fast biological chemicals interact. And it focuses on the specific pathway by which Gleevec blocks the action of ATP.

Gleevec successfully induces remission in some patients, but it does not work during the final stage of chronic myeloid leukaemia, which is known as a blast crisis. Mr Charusanti's model, which closely matches the behaviour of the drug in laboratory mice, shows that cells in blast crisis expel the drug too

quickly for it to be useful as an ATP-blocker. That suggests it might be useful to come up with a chemical which would slow down the pumping process by which malignant cells clear themselves of the drug.

Physicists can still feel smug. None of these models is a truly faithful representation of what is going on in and around a tumour. The situation is far too complex. But they are creating useful insights. As Richard Feynman, a Nobel-prize winning physicist, once said, “mathematics is a deep way of describing nature, and any attempt to express nature in philosophical principles, or in seat-of-the-pants mechanical feelings, is not an efficient way.” If cancer is ever to be understood properly, mathematical models such as these will surely play a prominent role.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Treating cancer

A burning (t)issue

Jan 22nd 2004
From The Economist print edition

Thermal treatments of cancer are remarkably effective

EVEN as some scientists are seeking to understand how cancer works, in order to treat it more effectively (see article), others prefer a more robust approach. They are exploring ways of killing cancer cells by heating them up without damaging surrounding healthy tissue. Although various such treatments have been tried in the past, advances in medical-imaging technology (which allow surgeons to see inside a body without opening it up) and improvements in the treatments themselves, mean that such treatments are receiving more and more attention.

At the end of 2003, Martin Mack of the Goethe University in Frankfurt told a meeting of the Radiological Society of North America, in Chicago, of his success in using lasers to treat secondary liver cancers. These secondaries were the results of cells from primary colorectal or breast cancers breaking off and lodging in the livers of the patients in question—1,400 of them. Such secondaries are hard to treat by traditional methods.

Dr Mack used magnetic-resonance imaging (MRI) to guide a fibre-optic probe through a patient's skin to the tumour. When the end of the probe was next to a tumour, he fired a laser beam through the optical fibre and blasted the cancer cells with it. He found that up to and including five years after the treatment, more patients who had had this treatment survived, than did those who had had traditional surgery.

Earlier last year Antonio Giorgio, and his colleagues at the Cotugno Hospital for Infectious Diseases in Naples, published a paper in the *American Journal of Roentgenology* describing their success in using radio waves, rather than laser light, to treat hepatocellular carcinoma, another form of liver cancer—and one that is among the deadliest in the world. Such radio waves act like the microwaves in an oven, heating organic matter up to the point where, if it was not dead already, it soon will be. But unlike Dr Mack, who used MRI, Dr Giorgio employed an ultrasonic scanner to help him guide the device which generated the radio waves to its target. Ultrasound machines are a lot cheaper than MRI machines, and also smaller. This technique is thus more attractive.

Indeed, ultrasound is being used not only for imaging, but also as a source of heat itself. This, potentially, is cheaper still, and it has the additional advantage of being non-invasive. That is because, like light waves, sound waves can be focused. The ultrasound generator used in this technique can focus its energy into a space about the size of a grain of rice. Thus concentrated, it shakes cells so violently that they heat up. But in front of the focus, and behind it, the energy density is lower, and little or no damage is done. David Cunningham and Gail ter Haar have used this technique to treat liver cancer at the Royal Marsden Hospital in London, while other groups in America, China and Japan, are using high-intensity sound to kill cancers in the prostate gland, uterus and brain. Hot stuff indeed.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Gorilla conservation

Good news, for a change

Jan 22nd 2004
From The Economist print edition

The number of mountain gorillas appears to be rising

Get article background

ONE might be forgiven for thinking that the story of wildlife conservation is one of unrelenting gloom, as forests are chopped down and savannahs put to the plough. However, a census carried out recently by the wildlife authorities of Congo, Rwanda and Uganda has revealed a bright spot. According to the census, the number of gorillas in the Virunga mountains, which those countries share, has risen by 17% since 1989.

Lest the champagne be broken out too soon, that figure represents an actual rise of only 56 animals. With a total of 380 in Virunga, and an estimated 320 in the delightfully named Bwindi Impenetrable National Park, in Uganda—the only other place that the subspecies is found—mountain gorillas are not, as it were, out of the woods yet. But it is clearly good news. And mountain gorillas have never been abundant. The first estimate of the Virunga population, made by George Schaller—then an eager young zoologist and now a veteran of the field—was 450 individuals. That was in 1959, just before independence and the subsequent outbreak of the first Congolese civil war.

War and poaching reduced the Virunga population to a low of about 260 in the late 1970s. Now, the area is at peace. Nor are poachers any longer the only people who make money out of the gorillas. Rwanda, in particular, has developed a lucrative eco-tourism industry based on rich foreigners who wish to follow in the steps of Dr Schaller and of Dian Fossey, an American researcher who brought the gorillas' plight to the world's attention, and was later murdered, probably by poachers who did not welcome the publicity. Eco-tourism gives local people a stake in conservation efforts, and thus an incentive to discourage poaching. As a result, the Virunga gorillas' future looks brighter now than it has for many years.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Space policy

Hubble trouble

Jan 22nd 2004
From The Economist print edition

Consequences of last week's announcement on manned spaceflight have begun

Get article background

Endangered species

WELL, it didn't take long for the first casualty of George Bush's new space policy to emerge and, to the surprise of few and the fear of many, it is the *Hubble* space telescope—the pride and joy of astronomers around the world. A visit by space shuttle scheduled for 2006, which would have fitted the telescope with new batteries and gyroscopes, has been cancelled. Without them, *Hubble* will lose both power and the ability to point in the right direction. As a result, it is expected to fail within a year or two. Its putative replacement, the *James Webb* telescope, is not due to go into orbit until 2011.

In truth, *Hubble* was already vulnerable. The recertification process required to get the space-shuttle fleet flying again requires that future missions must either be to an orbit which would allow them to reach the international space station if ground controllers think re-entry would prove unsafe, or must carry the equipment and expertise needed to fix damage to the heat shielding (it was damage of this sort that led to the loss of *Columbia*). It would have been tough for a *Hubble* mission to meet these criteria. And even before Mr Bush's announcement, the *Hubble* servicing mission was the only scheduled shuttle mission not headed for the space station, and so was the odd mission out even before NASA's re-orientation toward the moon.

Nor is it clear that the shuttle programme will restart according to schedule (the next launch is pencilled in for September 12th). An interim report released on January 20th by the Return to Flight Task Group, which was set up as an independent monitor of NASA's efforts to implement the recommendations of the board of enquiry that investigated the loss of *Columbia*, said that the agency was making progress. But as the report so eloquently puts it, “progress should not be mistaken for accomplishment.”

Still, it is symptomatic of the whole sorry mess that however awkward it would have been to mount a mission to revamp *Hubble*, it was this—perhaps the most scientifically useful task the shuttles could have done—which got the chop. John Grunsfeld, an astronaut who took part in a previous *Hubble*-servicing mission, said of the decision, “It's one that's in the best interest of NASA.”But whether it is in the best interests of science is a different question. Watch out for more such decisions in the future.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Richard Casement internship

Jan 22nd 2004
From The Economist print edition

We invite applications for the 2004 Richard Casement internship. This is for a would-be journalist aged 25 or under to spend three months of the summer working in London on the newspaper, writing about science and technology. Our aim is more to discover writing talent in a science student than scientific aptitude in a budding journalist. Applicants should write a letter introducing themselves, along with an original article of about 600 words which they think would be suitable for publication in the Science and technology section. They should be prepared to come for an interview in London or New York, at their own expense. Applications must reach us by February 20th. They should be sent by e-mail to casement@economist.com

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Dealing with North Korea

Nuclear futures

Jan 22nd 2004
From The Economist print edition

AP

Few small countries have caused more anxiety than North Korea—and yet have managed to remain so poorly understood

EACH of these recent books on North Korea aims to shed fresh light on two of our biggest areas of ignorance: what motivates Pyongyang's extreme hostility towards the outside world, and how best to part it from its claimed nuclear "deterrent". Each is withering about the myths and caricatures that are gleefully recycled in the press about the health and habits of the Kim family dynasty, who have ruled this secretive garrison-state for more than half a century. Each advocates engagement over containment or confrontation, though not always with confidence that this will ultimately coax North Korea out of its nuclear bunker.

As the three books illustrate over and over again, what passes for truth in the Hermit Kingdom is more troubling than the fictions told about it. There is the personality cult that ascribes to the North's current leader, Kim Jong Il, the authorship of 1,000 books while he was a student at college. There is the bizarre dynastic imperative that drove this younger Kim to make his dead dad, Kim Il Sung, president for eternity. And finally there is the awful fact that 50 years of Kim family rule have produced seven-year-olds who are on average eight inches shorter and 22 pounds lighter than their potential South Korean playmates—whom they are still forbidden to meet. Why would a regime prepared to inflict this on its own people stop at burning up the neighbourhood in a "sea of fire", a favourite cliché from North Korea's shrill propaganda machine?

Bruce Cumings has no sympathy for what the regime has done, but plenty for why it has supposedly done it. Its reclusiveness and ruthlessness, and its determination to brandish a nuclear bomb, are put down to what Mr Cumings calls the "holocaust" visited on North Korean cities by American bombs during the Korean war and to 50 years of barely disguised American racism.

North Korea: Another Country
By Bruce Cumings

The New Press; 241 pages; $24.95 and £14.95

Buy it at
Amazon.com
Amazon.co.uk

Nuclear North Korea: A Debate on Engagement Strategies
By Victor D. Cha and David C. Kang

Yet Mr Cumings, no less than the pundits he so savagely disparages, picks his facts to fit his prejudices. His America-as-baddy version of North Korea's history—not to mention that of other nations—fails to account for the pattern of North Korean cheating, which has gone on relentlessly through better dealings with the outside world and worse ones. And beyond North Korea's fear of America lies another, perhaps deeper, fear: the regime's worries about its own safety. The trouble for Mr Cumings is that little that America or anyone else does, whether through containment or engagement, is likely to give the Kims, once history catches up with them, the job security they crave.

The worry that nuclear weapons could give the Kims the option of going out, some day, with a bang is what drives both Victor Cha and David Kang, and Michael O'Hanlon and Mike Mochizuki, to argue that one last round of bargaining should be attempted to cure North Korea of its bad nuclear habits. Messrs Cha and Kang debate tough versus tender engagement in alternating chapters: one concludes optimistically that there is little danger of conflict and that more North Korean intransigence should be countered by redoubled engagement; the other is more alarmed that North Korea's addiction to coercive bargaining (inadvertently fostered by the Clinton administration) may yet trigger conflict by miscalculation. All the more reason, argues the tougher Mr Cha, for Bush administration officials to explore engagement seriously, if only to persuade the neighbours that all else has failed, should tougher measures eventually be called for.

Setting out a similar train of thought in greater detail, Messrs O'Hanlon and Mochizuki want to offer North Korea a “Grand Bargain” amounting to some $2 billion-worth of aid and assistance a year for a decade. This, they argue, will force Kim Jong Il's regime to reform on the world's terms, even if it does not want to. Yet if that is indeed what the Kims are determined to avoid with their bomb-making, the chance of success is dispiritingly slight.

North Korea: Another Country.
By Bruce Cumings.
The New Press; 241 pages; $24.95 and £14.95

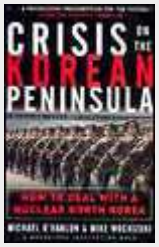
Nuclear North Korea: A Debate on Engagement Strategies.
By Victor D. Cha and David C. Kang.
Columbia University Press; 265 pages; $24.95

Crisis on the Korean Peninsula: How to Deal with a Nuclear North Korea.
By Michael O'Hanlon and Mike Mochizuki
McGraw-Hill/Brookings Institution; 230 pages; $19.95 and £14.99

Columbia University Press; 265 pages; $24.95

Buy it at
Amazon.com
Amazon.co.uk

Crisis on the Korean Peninsula: How to Deal with a Nuclear North Korea
By Michael O'Hanlon and Mike Mochizuki



McGraw-Hill/Brookings Institution; 230 pages; $19.95 and £14.99

Buy it at
Amazon.com
Amazon.co.uk

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

McCarthyism

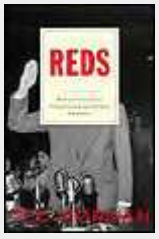
Naked truths

Jan 22nd 2004
From The Economist print edition

IT WAS once said of Cardinal Richelieu that he did too much harm to be praised and too much good to be damned. The same can be said of America's McCarthyites. The American government was right to be worried about the possibility of Soviet subversion. But the McCarthyites' cavalier use of evidence, their inability to distinguish between communism and liberalism, their insistence that reds lurked under almost every bed, ended up discrediting the cause that they espoused.

The problem with most histories of McCarthyism is that they miss this essential ambivalence. Liberals have presented McCarthyism as a tale of power abused and freedoms trampled. Conservatives have retorted that all too many of the so-called innocent radicals were, in fact, agents of the Soviet Union. Ted Morgan's new history is as balanced as it is readable.

Reds: McCarthyism in Twentieth-Century America
By Ted Morgan



Random House; 704 pages; $35

Buy it at
Amazon.com
Amazon.co.uk

Mr Morgan argues that McCarthyism started long before Joe McCarthy stood up in front of the West Virginia Republican Women's Club in February 1950, and announced that he had in his hand a list of 205 members of the Communist Party working in the State Department. It started with the Bolshevik revolution in 1917.

If the revolution inspired radicals like John Reed to join the communist experiment, it also inspired more conservative Americans to try to abort it. Woodrow Wilson attempted America's first ever experiment in “regime change” when he sent American troops to fight Bolshevik soldiers on Russian soil. McCarthy did not even invent the idea of using a congressional committee to harass suspected communists. That distinction belongs to Martin Dies, a congressman from East Texas who invented the House Committee on Un-American Activities in 1938. Dies claimed to have a list of 300,000 active fifth columnists, and was particularly worried about communist spies within the federal government.

Mr Morgan is also careful to argue that the communist threat in America was more than just a McCarthyite invention. The McCarthyites may have exploited communism for political advantage; they may have stretched the evidence and smeared the innocent. But by treating it as a recruitment pool for potential agents, there is no doubt that the Soviet Union tried to use the American Communist Party to further its ends and subvert the government. Dozens of American communists penetrated the administration, some at the highest levels, and stole scientific and political secrets, including information on the atomic bomb. KGB archives leave no doubt that the “martyrs to McCarthyism”—Alger Hiss and the Rosenbergs—were tools of Soviet power.

Where did Joe McCarthy fit into all this? Mr Morgan shows that, however real it once had been, the communist threat was already under control when the senator for Wisconsin launched his crusade. The late 1940s had seen a highly effective campaign against communism, with Harry Truman bringing the full weight of the government down on the party, trade unions expelling party members and Whittaker Chambers exposing communist agents in the government. By 1950, leading communist moles such as Harry Dexter White in the Treasury and Alger Hiss in the State Department were either dead or discredited, and the Communist Party was a walking corpse. McCarthy arrived after the battle was over to finish off the wounded and warn of fresh attacks.

So why did he become such a potent name? One reason was timing: McCarthy rose to prominence when fear of communism still raged, thanks to the Soviet Union's acquisition of the atomic bomb, the Communist Party's takeover of China, and the outbreak of the Korean war. But McCarthy added three

ingredients. The first was an extraordinary disregard for facts; on the very day he launched his campaign his estimates of how many communists were to be found in the State Department veered between 100 and 205. The second was his menacing personality. McCarthy drank a bottle of spirits a day, often starting before breakfast, which explains why he died of alcoholism in his late 40s. His entourage included unstable and disreputable bullies such as Roy Cohn as well as stable and reputable bullies such as Robert Kennedy. The third was his enthusiasm for tarring the entire American establishment, from Harvard University to the army, with the communist brush.

McCarthy became a favourite whipping boy for the left. Yet McCarthyism allowed many people to ignore evidence that the Soviet Union had used the American Communist Party to advance its ends. It also turned him into a hero of the burgeoning conservative movement. McCarthy showed how popular distrust of the establishment could be turned into one of the most powerful weapons in the Republican Party's armoury.

Just as McCarthyism began long before Joe McCarthy, it endured long after him. Edgar Hoover used every move in McCarthy's book to smear Martin Luther King. Richard Nixon, who made his reputation as a communist-baiter, surrounded himself with McCarthy admirers, and once told his close aides that his administration needed “a guy who's mean, tough, ruthless. He'll lie, he'll do anything. We want somebody to be a McCarthy.” At the same time, being accused of McCarthyism was enough to deflect any criticism, however accurate. Anyone who wants to understand why Joe McCarthy continues to exercise such a grip on the American imagination could do no better than to read this book.

Reds: McCarthyism in Twentieth-Century America.
By Ted Morgan.
Random House; 704 pages; $35

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Medical research

Ego men

Jan 22nd 2004
From The Economist print edition

WHEN scientists gathered at the White House nearly four years ago to announce that they had sequenced the human genome, it was hailed as the “most wondrous map ever produced by humankind”. Knowing the identity, and order, of the three billion biochemical building blocks which make up man's DNA promised the key to improving health, prolonging life and understanding human nature.

But look carefully at the word “genome” and you'll find “ego men” within. James Shreeve's new book, which examines the 17-year struggle to decode mankind's genetic blueprint, reveals why. Humanity's finest hour was achieved through, and often in spite of, a clash of giant personalities. The central struggle was between the publicly funded international Human Genome Project, led by Francis Collins, a distinguished scientist and devout Christian, which pursued a slow-and-steady approach to sequencing until Celera, a private company led by Craig Venter, appeared on the scene and boldly claimed that its revolutionary new technique, whole-genome shot-gun sequencing, could do the job in less than half the time. The ensuing rivalry led both sides to public sniping, brazen promises, uneasy alliances, awkward compromises and desperate deadlines. Mr Shreeve's book, largely based on personal interviews, is a detailed and immensely entertaining account of this scientific joust.

The Genome War: How Craig Venter Tried to Capture the Code of Life and Save the World
By James Shreeve

Knopf; 416 pages; $26.95

Buy it at
Amazon.com
Amazon.co.uk

Described both as “an inspiration” and “an opportunistic maniac”, Dr Venter looms large in “The Genome War”, from his slacker days as a teenager in California, to the horrors of his tour of duty in Vietnam. The scientist is generally reviled by academics for trying to patent many of his genomic discoveries. But Mr Shreeve paints Dr Venter more as a man who started out believing in public access to such riches, but got caught up in corporate interests which eventually forced him out of Celera. In the course of tracing how close the company came to failing, “The Genome War” also highlights the contrast between Dr Venter's brash surface and his deeper frailties.

Mr Shreeve does the same for the publicly funded Human Genome Project, probing its organisational flaws and petty rivalries. But he is careful never to allow the big egos to dominate the story: “The Genome War” is all the more interesting for revealing such quiet heroes as Hamilton Smith, a reclusive Nobel prize winner who was crucial to Celera's success, as well as for its observations on outspoken grandees such as James Watson, who co-discovered the structure of DNA. Nor does the book shy away from tackling the technical complexities central to this story, from the intricate science of genomic sequencing to the pressures of the biotech business.

In the end, both sequencing projects hobbled across the finishing line together. It would take another three years before the publicly funded project produced a complete sequence of the human genome, and many more again before what Mr Shreeve calls the “muck of ego, political posturing and accusations of fraud” began to fade away. Still, the world is all the richer for the human genome sequence, whatever road it took to get there.

The Genome War: How Craig Venter Tried to Capture the Code of Life and Save the World.
By James Shreeve.
Knopf; 416 pages; $26.95

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

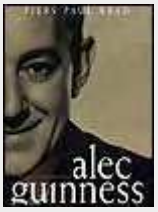
Biography

Rich man, poor man

Jan 22nd 2004
From The Economist print edition

TO WRITE an authorised biography is to enter a Faustian pact: access in return for respect. This often unsexes the work, though not in this case. Piers Paul Read has the eye and ear of a fine novelist, and his life of Sir Alec Guinness is not a conventional theatrical biography, though it does contain some very funny theatrical stories. (Laurence Olivier said of Guinness's performance in "Twelfth Night": "Fascinating, old dear. I never realised before that Malvolio could be played as an old bore.")

Alec Guinness: The Authorised Biography
By Piers Paul Read



Simon and Schuster; 632 pages; £20

Buy it at Amazon.co.uk

The book begins unforgettably: "'My mother was a whore,' [Guinness] told the author John le Carré"; and ends no less memorably: "If a biographer called Gary O'Connor should approach you, tell him to fuck off." In between we learn about an unhappy childhood, the insecurity it caused and the reasons for his passion for privacy.

This is a long book, but it is so well paced that there are no longueurs, even when Mr Read, a Catholic himself, digs into the entrails of Guinness's Catholicism. But what an old misery he could be. He was frequently cruel to his wife Merula—especially about her cooking. ("M neglected to wash the asparagus so it was spoiled by a lot of sand.") He loved his wife and son, but was burdened by a homosexual alter-ego from which, Mr Read writes, "he was not altogether able to detach himself."

Guinness particularly enjoyed meeting good-looking heterosexual men, men such as his biographer. Mr Read wonders if this was not his way of enjoying a sexual frisson without falling into sin. Conjugal relations with Merula seem to have ended when they were both 40, but Guinness seems not to have succumbed. "Though it might have been true to his sexual nature, it would have put at risk the marriage and family life which, after his rootless childhood, he valued so highly."

He must have been an angry man; but this is a biography of a celebrated actor, and we also need to know how good he was. He was a brilliant Fool to Olivier's Lear, but that was in 1946. Guinness's two Hamlets got very mixed reviews and his Macbeth was a disaster. Sir John Gielgud, who was often cruel when he meant to be kind, once asked why Guinness did not do more of "those little parts you do so well".

He was magnificent in Ealing film comedies such as "Kind Hearts and Coronets", and when he played neurotic officers in "The Bridge on the River Kwai" and "Tunes of Glory". A large audience will remember his George Smiley in the television adaptation of Mr le Carré's "Tinker, Tailor, Soldier, Spy". A 2% share of the producer's profit for his Ben (Obi-Wan) Kenobi in "Star Wars" earned him £4.5m. Afterwards, he complained about the tax bill. Guinness aspired to be a great actor and he provided glimpses of greatness. By the standards of most actors that would be something, but not for Guinness, who judged himself a failure. Unhappy man; good book.

Alec Guinness: The Authorised Biography.
By Piers Paul Read.
Simon and Schuster; 632 pages; £20

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

New fiction

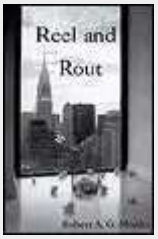
The way up

Jan 22nd 2004
From The Economist print edition

MEDIA mogul Cedric “Drive” Rhodes, a South African version of Rupert Murdoch, launches a hostile takeover bid for the *American Observer*, an institution much like *Reader's Digest*—at least in that it has been run since the death of its founders by a group of unaccountable trustees, who have done a lousy job. The terms of the trust ought to make the bid impossible. But Rhodes has assembled the very best lawyers, private eyes and public-relations experts. And he has also secured the backing of a bank trying to break into Wall Street's investment-banking elite and willing to break down a few Chinese walls in order to do so—reminiscent of, well, any number of banks during the late 1990s.

He has also bought anyone who matters in the media and politics, and is confident of the most positive press and political favours even from the very top. Make that almost anyone: in his way stand two blue-bloods. Molly Munro is a Harvard-educated American aristocrat, whose friendship with Hillary Clinton led to an appointment in the Labour Department, where she regulates corporate pension funds. This matters because the employee-owned pension plan of the *American Observer* also wants to buy the firm and is being advised by another aristocrat, and Vietnam war hero, nicknamed Horse (for reasons made all too clear in an unnecessarily long sex scene).

Reel and Rout
By Robert A.G. Monks



Brook Street Press; 350 pages; $23.95

Buy it at
Amazon.com
Amazon.co.uk

The ensuing battle for control makes a good enough yarn to prompt the thought that, whereas there are countless readable-yet-technical novels on legal matters, notably by John Grisham and his imitators, novels about business are a rarity.

“Reel and Rout” borrows from the Grisham genre by giving the law and lawyers a central role. It is also a tale well told, in airport style, and, like a Grisham, it rings horribly true. This is unsurprising, as the first-time novelist, at the age of 70, is Bob Monks, a long-time shareholder activist, a former senior official in the Labour Department—and American aristocrat to boot. The book is a trove of detail about the secret places used by the elites that run American business and politics. Important events take place during a round of golf at The Country Club in Brookline, at the headquarters of the Society of Cincinnati (America's “oldest patriotic organisation”) and over lunch at the Brook—a club where membership is bought “as an implicit condition of favourable business relationships”.

The pervasive and damaging effect of clubbishness at the top of American life is often overlooked in modern popular novels—being mistakenly dismissed, perhaps, as a British thing. But Mr Monks knows the reality that “clubs are rather anomalous in a society profoundly committed to democratic principles, but they have been in existence since the earliest days of the Republic.” His disgust at this anomaly, and its sorry consequences, gives the novel its energy and will not be lost on his readers.

Reel and Rout.
By Robert A.G. Monks.
Brook Street Press; 350 pages; $23.95

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

New York theatre

Curtain crises

Jan 22nd 2004
From The Economist print edition

It is never easy for a Broadway show to get to opening night

The cat calls

IT'S been a topsy-turvy season so far on Broadway, where the greatest achievement, it seems, is making it to opening night. A one-time Charlie's Angel, Farrah Fawcett, wasn't so lucky, closing after a week of previews in what was to have been her Broadway debut in “Bobbi Boland”. (Programmes from the speedy disappearing act are doing brisk business on eBay.) Ellen Burstyn fared scarcely better, lasting just to opening night in the Oscar-winner's solo show, “The Oldest Living Confederate Widow Tells All”—and then closing immediately afterwards, following tepid reviews that have been the season's norm to date.

Sometimes the shows did open, only to be divested along the way of crucial cast members. Last June, Richard Greenberg won the Tony award for best play for his canny baseball drama, “Take Me Out”, a winning treatise on the intersection of American sport and sexuality. Mr Greenberg fared less well this time with “The Violet Hour”, which haemorrhaged two of its five cast members (both of the women) before opening to wildly divergent reviews. Even leading man Robert Sean Leonard, who commendably stayed the course, couldn't make sense of a muddled time-travel play that paid homage to F. Scott Fitzgerald and H.G. Wells while amplifying Mr Greenberg's also-ran status with regard to both writers. Mary Tyler Moore put off her much-anticipated return to the stage in Neil Simon's “Rose's Dilemma” and must be pleased that she did: now well into his 70s, Mr Simon has rarely received such poor reviews.

The mood isn't entirely gloom and doom. If quantity is any gauge, Broadway can be said to be humming, having survived the busiest autumn in memory: the ceaseless cavalcade of openings was of the sort that one normally associates with the run-up to the Tony awards in the late spring. (Indeed, the second half of the Broadway season looks to be markedly quieter than the first.) And in that headlong rush were some real gems. Anthony Page's revival of “Cat On a Hot Tin Roof”, which runs until March 13th at the Music Box theatre, stars Ashley Judd as a febrile, aptly claws-bared Maggie, and marks the British director's second bout with Tennessee Williams's play in three seasons.

For all the backstage gossip about backstabbing amongst its cast, this staging is a notable improvement on Mr Page's previous West End version, in which Brendan Fraser (late of “The Mummy”) headed the cast as an entirely leaden Brick, the child-crazed Maggie's diffident husband. On this occasion, the role of Brick, the sullenly gay one-time football hero, has been passed to another film star, Jason Patric, who at least looks like he once was a jock, and he is superlatively paired with Ned Beatty (a holdover from the London version) in a bravura turn as Big Daddy, and veteran film actress Margo Martindale, who anchors a long evening with her tender yet frightened Big Mama.

Across the street at the Booth theatre in an open-ended run is a British play, William Nicholson's pretentiously titled “The Retreat From Moscow”, directed to kill by an American, Daniel Sullivan, who has given a potentially routine domestic drama a production of infinite polish. The trio of actors—all three of them superb—is dominated by Dame Eileen Atkins, playing a wife who won't stop needling her husband (a movingly weary John Lithgow) and then has to deal with the consequences when he cries, “Enough!” Navigating between the two is their son, played by Ben Chaplin with the rueful wariness of a longstanding witness to parental hurt, an heir apparent to damage no matter how briskly he denies it.

Uptown at Lincoln Centre, there was more melancholy to be had in the outsized form of a once-wiry

Kevin Kline, here padded to play Falstaff in a nearly four-hour version of “Henry IV” that conflates Shakespeare's two history plays into one. (The literary compression is courtesy of a cast member, Dakin Matthews.) Larger than life, as this character must be, and yet also acutely aware of death, Mr Kline's Falstaff lent Jack O'Brien's solid if uninspired production a lasting air of grace. If it weren't Shakespeare, it, like several others this season, might never have made curtain-up.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Kiharu Nakamura

Jan 22nd 2004
From The Economist print edition

Telegraph

Kiharu Nakamura, a geisha, died on January 5th, aged 90

THE question was one familiar to Kiharu Nakamura: what exactly was a geisha? In television interviews, at lectures and in her books she would explain that the word was composed of two Japanese characters, *sha* meaning entertainer and *gei* meaning artistic. Artistic entertainer: was that all? All? Miss Nakamura would list the accomplishments of a successful geisha: she would have to play musical instruments with feeling, usually the *shamisen*, a type of guitar, and the *tuzumi*, a small drum; she would have to sing and dance well and, most important, be a good conversationalist, with a ready flow of stimulating repartee.

What about sex? Miss Nakamura considered the word carefully. Perhaps, she said, the questioner was thinking of the *oiran*? Like a geisha, an *oiran* was a cultured woman but would be available to spend the night with a man for a high fee. The two professions were often confused by westerners. That said, it would be misleading to suggest that a geisha never had sex. She might form a relationship with a client and sex would follow naturally. But the distinguished men Miss Nakamura entertained, many of them important politicians and industrialists, were often too tired for sex or too old to bother with it. What they wanted was for their cares to be lifted for a few hours, to be soothed and perhaps gently amused. A geisha, she said, “knew how to handle men”. They might boast to their friends that they were real dogs, but Miss Nakamura knew different. And of course she would never betray a confidence.

The idea that geishas were tarts seems to have been spread by soldiers from America and other victorious countries who occupied Japan after it was defeated in 1945. The girls who serviced the soldiers were happy to call themselves geishas and often wore geisha costumes, as many still do today. Geisha culture continues to be studied by Japanese historians. But for Miss Nakamura the war had ended a profession that dated back hundreds of years to a time when only men were considered to have the accomplishment to be geishas (just as today men still play the female roles in *kabuki* theatre). In old age she saw herself as one of the few surviving classical geishas, perhaps the last one.

The rebel

She must have been a handful as a daughter. Her parents had assumed that she would have an arranged marriage: that was the way things were in the Ginza district of Tokyo, where her father was a doctor. But the teenager had other ideas. She was fascinated by Tokyo's apprentice geishas as they paraded around

town, and she copied their fancy costumes and heavy make-up. She stamped her little clogs and eventually her parents gave way.

At 15 she entered a school for geishas run by teachers who were honoured as “living national treasures”. She in turn became the treasure of the school. Her teachers were charmed by the quavers she put into her voice and her ability to walk with her feet together. She tolerated subjects she found boring, such as flower arranging. The name she had been born with, Kazuko, was changed to Kiharu, which means happy spring. She says she managed to avoid the ceremony of *mizuage* (deflowering) by conversing with the guest who had paid for the privilege until he fell asleep.

She was one of the few geishas to learn English. Visitors to Japan who were curious about geishas were brought to see her. Most are now forgotten, but they were famous at the time: baseball's Babe Ruth, William Randolph Hearst, the model for “Citizen Kane”, and Jean Cocteau, a French writer and artist who was smitten and wrote a poem about Kiharu.

Japan's secret service, perhaps influenced by stories of Mata Hari, a dancer who became a spy in the first world war, asked Miss Nakamura to spy on a foreign client. Understandably, she was a reluctant agent: Mata Hari had been shot at dawn. But no doubt she did her patriotic duty. When Japan went to war in 1941 she travelled to India, carrying a message from the Japanese government of support for an anti-British movement.

At the end of the war, Miss Nakamura felt that the geisha profession, like Tokyo itself, had been destroyed. She was 32, she had some savings and a baby son from a brief marriage. She worked for several years as a translator in Japan, but the future, she decided, was America. Her new life there was, in its way, a typical immigrant's success story. She had something to sell, her experience as a geisha and of Japanese culture, and she worked hard to market it. When the Metropolitan Opera did “Madame Butterfly” they employed Miss Nakamura as an adviser. Puccini's story might be ridiculous, but at least she could ensure that the costumes were correct.

Her ten books, memoirs and novels brought her into contact with universities. Perhaps her best known work, “The Memoir of a Tokyo-born Geisha”, has been translated into eight languages. Miss Nakamura's lectures at Princeton, Columbia and other institutions were packed out. She would entrance her audience with the same verve she had shown when she entertained her clients as a geisha. “Now, another question, please, preferably not about sex.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Jan 22nd 2004
From The Economist print edition

America's factories failed to meet analysts' expectations for output growth in December. Industrial production rose by only 0.1% during the month, yet increased at an annual rate of 2.3% in the year to December, up from 1.7% in the year to November.

American consumers are feeling optimistic. The University of Michigan's consumer confidence index jumped to 103.2 in its preliminary reading for January, up from 92.6 in December. Consumers are especially confident about improvements in the labour market. America's robust housing market has also continued its recent growth. Housing starts rose by 1.7% in December and hit a 25-year high. Applications for new mortgages surged in early January.

The **euro,** which nearly hit $1.30 in recent weeks, suffered a setback. It fell to $1.24, thanks to comments by European Central Bank officials, before bouncing back slightly.

November trade figures suggest that a strengthening currency helped to reduce the **euro area's trade surplus**, which slid to *euro*5.0 billion ($5.9 billion) during the month. Exports fell by 6.5% in the year to November.

Euro-area industrial output rose by 1.2% in the year to November. Industrial output rose by 0.2% in **Italy** over the same period.

Annual consumer-price inflation in the **euro area** in December was revised down from 2.1% to 2.0%. The revision brings the European Central Bank closer to its goal of keeping annual consumer-price growth below, but as close as possible to, 2.0%. Despite the decline in inflation, few economists took it as a reason to change their forecasts of ECB interest-rate policy.

Outside the euro area, factories are busier. Industrial production in **Sweden** rose by 3.0% in the year to November. In **Denmark**, it rose by 1.4%, over the same period.

Canada's central bank cut interest rates by one quarter of a percentage point, from 2.75% to 2.50%. In its statement, the bank said that the country's economic growth had been weakened by a rising Canadian dollar. However, the currency defied expectations by rising against the greenback just after the rate cut.

Britain's new target measure of inflation, the CPI, rose by 1.3% in the year to December, unchanged from the year to November.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Output, demand and jobs

Jan 22nd 2004
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2003	2004	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.6	Q3	+ 4.8	+ 2.8	+ 3.6	– 0.1	Q3	+ 5.3	Q3	5.6	Dec	6.1
Austria	+ 0.8	Q3	+ 1.4	+ 0.8	+ 1.9	+ 2.6	Jul	– 4.0	Aug	4.5	Nov	4.3
Belgium	+ 0.8	Q3	+ 2.2	+ 1.0	+ 1.9	– 6.6	Nov	+ 3.4	Oct	12.7	Dec†	11.7
Britain	+ 2.0	Q3	+ 3.1	+ 2.0	+ 2.8	– 0.5	Nov	+ 3.7	Nov	4.9	Nov††	5.2
Canada	+ 1.0	Q3	+ 1.1	+ 1.7	+ 3.1	– 0.3	Oct	+ 2.4	Oct	7.4	Dec	7.5
Denmark	– 0.5	Q3	– 0.8	+ 0.5	+ 2.2	+ 1.4	Nov	+ 5.5	Oct	6.5	Nov	5.4
France	– 0.3	Q3	+ 1.5	+ 0.2	+ 1.9	+ 1.1	Nov	– 2.2	May	9.6	Nov	9.2
Germany	– 0.2	Q3	+ 0.9	– 0.1	+ 1.7	+ 1.0	Nov	– 2.5	Nov	10.4	Dec§	10.1
Italy	+ 0.5	Q3	+ 2.0	+ 0.5	+ 1.7	+ 0.2	Nov	– 1.5	Oct	8.4	Oct	8.9
Japan	+ 1.8	Q3	+ 1.4	+ 2.4	+ 2.1	+ 2.4	Nov	– 3.0	Nov	5.2	Nov	5.3
Netherlands	– 1.1	Q3	+ 0.5	– 0.7	+ 1.1	– 0.9	Nov	– 4.7	Oct‡	5.7	Nov**	4.3
Spain	+ 2.4	Q3	+ 2.9	+ 2.4	+ 3.0	+ 2.0	Nov	+ 4.1	Oct	11.3	Nov	11.5
Sweden	+ 2.0	Q3	+ 1.9	+ 1.6	+ 2.5	+ 3.0	Nov	+ 3.9	Nov	5.3	Nov†	4.1
Switzerland	– 0.6	Q3	+ 1.0	– 0.4	+ 1.6	+ 0.4	Q3	– 4.0	Nov	4.1	Dec†	3.3
United States	+ 3.6	Q3	+ 8.2	+ 3.1	+ 4.5	+ 2.3	Dec	+ 8.3	Nov	5.7	Dec	6.0
Euro area	+ 0.3	Q3	+ 1.5	+ 0.5	+ 1.9	+ 1.2	Nov	nil	Oct	8.8	Nov	8.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 1.6	Q3	+ 3.2	na	na	+ 0.3	Nov	+ 5.3	Oct	8.2	Dec†	8.1
Greece	+ 5.0	Q3	+ 1.8	na	na	– 0.3	Aug	+11.2	Aug‡	na		na
Iceland	+ 3.2	Q3	na	na	na	– 0.3	2002	na		2.8	Oct†	2.5
Ireland	– 0.1	Q3	na	na	na	+15.7	Nov	+ 1.0	Oct	4.7	Dec	4.3
Luxembourg	+ 1.3	2002	na	na	na	+ 4.3	Oct	+ 2.2	Aug	4.1	Nov	3.3
New Zealand	+ 3.5	Q3	+ 6.3	na	na	+ 4.1	Q3	+ 6.1	Q3	4.4	Q3	5.4
Norway	+ 0.2	Q3	+ 3.3	na	na	+ 2.1	Nov	+ 1.6	Nov	4.7	Q3	3.8
Portugal	– 0.9	Q3	– 2.1	na	na	+ 1.4	Nov	– 0.4	Nov	6.3	Q3†	5.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Sep-Nov; claimant count rate 3.0% in Dec. §EU harmonised rate 9.2% in Dec. **Sep-Nov.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Prices and wages

Jan 22nd 2004
From The Economist print edition

% change on year ago

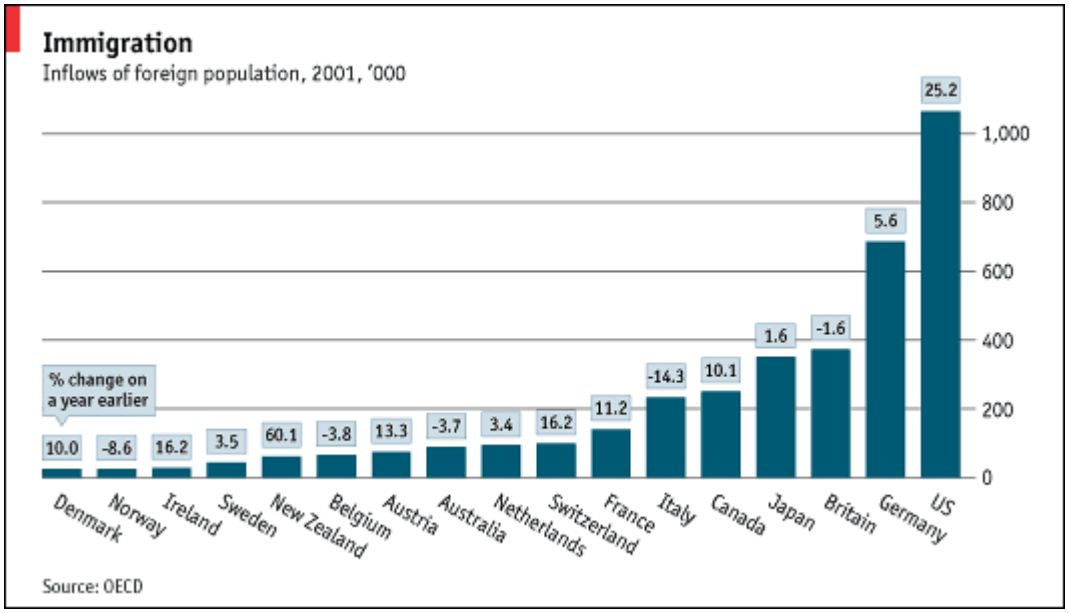
	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2003	2004	latest		year ago	latest		year ago
Australia	+ 2.6	Q3	+ 3.2	+ 2.7	+ 2.3	– 0.1	Q3	– 0.2	+ 5.1	Q3	+ 3.6
Austria	+ 1.2	Dec	+ 1.8	+ 1.3	+ 1.2	+ 2.5	Dec	+ 0.8	+ 2.3	Nov	+ 2.2
Belgium	+ 1.7	Dec	+ 1.4	+ 1.5	+ 1.4	– 0.4	Dec	+ 1.4	+ 1.8	Q4	+ 2.2
Britain	+ 1.3	Dec*	+ 1.7	+ 2.8†	+ 2.5†	+ 1.8	Dec	+ 1.0	+ 3.5	Nov	+ 3.8
Canada	+ 1.6	Nov	+ 4.3	+ 2.7	+ 1.6	– 4.0	Nov	+ 2.3	+ 3.1	Oct	+ 2.3
Denmark	+ 1.4	Dec	+ 2.5	+ 2.1	+ 1.6	+ 0.2	Dec	+ 1.3	+ 3.6	Q3	+ 3.9
France	+ 2.2	Dec	+ 2.3	+ 2.1	+ 1.7	+ 0.7	Nov	+ 0.9	+ 3.0	Q3	+ 3.5
Germany	+ 1.1	Dec	+ 1.2	+ 1.1	+ 1.1	+ 1.3	Dec	+ 1.1	+ 1.6	Nov	+ 2.8
Italy	+ 2.5	Dec	+ 2.8	+ 2.8	+ 2.3	+ 1.1	Nov	+ 1.6	+ 2.5	Nov	+ 2.2
Japan	– 0.5	Nov	– 0.4	– 0.2	– 0.2	– 0.1	Dec	– 1.3	+ 0.6	Nov	+ 0.6
Netherlands	+ 1.7	Dec	+ 2.8	+ 2.2	+ 1.7	+ 2.6	Nov	+ 2.2	+ 1.4	Jan	+ 3.5
Spain	+ 2.6	Dec	+ 4.0	+ 2.9	+ 2.6	+ 1.3	Nov	+ 1.6	+ 3.1	Q3	+ 3.8
Sweden	+ 1.4	Dec	+ 2.3	+ 2.1	+ 1.5	– 1.6	Nov	– 0.8	+ 3.1	Oct	+ 3.1
Switzerland	+ 0.6	Dec	+ 0.9	+ 0.6	+ 0.5	– 0.2	Dec	– 0.4	+ 1.8	2002	+ 2.5
United States	+ 1.9	Dec	+ 2.4	+ 2.3	+ 1.5	+ 4.0	Dec	+ 1.2	+ 2.0	Dec	+ 3.2
Euro area	+ 2.0	Dec	+ 2.3	+ 2.0	+ 1.7	+ 1.4	Nov	+ 1.1	+ 2.6	Q3	+ 3.1
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.6	Dec	+ 1.7	na	na	– 0.4	Dec	+ 1.4	+ 3.9	Q3	+ 4.1
Greece	+ 3.1	Dec	+ 3.4	na	na	+ 1.5	Sep	+ 1.9	na		na
Iceland	+ 2.4	Jan	+ 1.4	na	na	+ 1.3	Jan	+ 2.7	+ 5.5	Nov	+ 5.7
Ireland	+ 1.9	Dec	+ 5.0	na	na	– 8.4	Nov	– 3.0	+ 4.7	Q3	+ 6.0
Luxembourg	+ 2.1	Dec	+ 2.2	na	na	+ 0.8	Nov	– 0.1	+ 5.0	Oct	– 0.1
New Zealand	+ 1.6	Q4	+ 2.7	na	na	+ 0.1	Q3	– 2.1	+ 2.3	Q3	+ 2.3
Norway	+ 0.6	Dec	+ 2.8	na	na	+ 0.7	Dec	+10.1	+ 4.3	Q3	+ 5.0
Portugal	+ 2.4	Dec	+ 4.0	na	na	nil	Dec	+ 1.3	– 1.7	Nov	– 0.5

* New series. RPI inflation rate in December: 1.8%. † RPI.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Immigration

Jan 22nd 2004
From The Economist print edition



In 2001, America took in more than one million permanent immigrants, which is equivalent to around 0.4% of its total population. Measured relative to population, however, immigration is even more significant in other countries, according to the OECD. New Zealand, for example, received just over 62,000 immigrants in 2001, but this was equivalent to around 1.5% of its population of 4m.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Money and interest rates

Jan 22nd 2004
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jan 21st 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 8.7	+13.0	Nov	5.56	4.79	5.32	5.67	5.21	6.52
Britain	+ 7.3	+ 6.7	Dec	3.97	3.91	4.24	4.72	4.33	5.50
Canada	+ 5.2	+ 6.0	Nov	2.33	2.74	2.61	4.51	4.91	6.07
Denmark	+ 8.1	+ 9.9	Nov	2.30	3.11	2.52	4.27	4.31	5.34
Japan	+ 4.1	+ 1.5	Dec	0.03	0.03	0.08	1.34	0.81	1.45
Sweden	+ 2.9	+ 3.6	Nov	2.57	3.66	2.68	4.56	4.59	3.32
Switzerland	+21.0	+ 7.6	Dec	0.24	0.60	-0.25	5.50	2.34	2.51
United States	+ 6.3	+ 3.3	Dec	1.05	1.25	1.65	4.03	3.92	5.70
Euro area†	+10.7	+ 7.4	Nov	2.08	2.83	2.39	4.11	4.05	3.90

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.22%, Japan No. 256 1.34%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 3.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Economist commodity price index

Jan 22nd 2004
From The Economist print edition

1995=100

	Jan 13th	Jan 20th*	% change on one month	% change on one year
Dollar index				
All items	92.2	92.9	+ 5.6	+20.9
Food	90.0	90.9	+ 6.4	+14.8
Industrials				
All	95.2	95.7	+ 4.6	+29.7
Nfa†	93.3	94.8	+ 5.7	+25.7
Metals	96.8	96.4	+ 3.7	+33.2
Sterling index				
All items	78.6	80.7	+ 2.6	+ 7.0
Euro index				
All items	94.8	97.2	+ 4.4	+ 2.7
Yen index				
All items	104.2	106.1	+ 5.5	+ 9.4
Gold				
$ per oz	424.75	411.25	+ 0.4	+15.3
West Texas Intermediate				
$ per barrel	34.36	36.00	+12.4	+ 5.7

* Provisional. † Non-food agriculturals.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Stockmarkets

Jan 22nd 2004
From The Economist print edition

Market indices

	Jan 21st	2003-04 high	2003-04 low	% change on one week	% change on record high	% change on Dec 31st 2002 in local currency	% change on Dec 31st 2002 in $ terms
Australia (All Ordinaries)	3,320.7	3,325.4	2,673.3	+ 0.2	– 3.5	+11.6	+52.1
Austria (ATX)	1,700.0	1,709.8	1,120.2	+ 1.6	– 2.1	+47.8	+77.0
Belgium (Bel 20)	2,387.5	2,387.5	1,426.6	+ 1.7	–35.2	+17.9	+41.2
Britain (FTSE 100)	4,511.2	4,518.1	3,287.0	+ 1.1	–34.9	+14.5	+29.2
Canada (Toronto Composite)	8,621.9	8,623.6	6,228.6	+ 2.6	–24.3	+30.3	+59.8
Denmark (KBX)	223.4	227.9	145.0	– 0.5	–26.0	+34.4	+60.5
France (SBF 250)	2,497.2	2,503.4	1,630.1	+ 1.7	–43.1	+21.6	+45.7
(CAC 40)	3,676.4	3,690.0	2,403.0	+ 1.8	–46.9	+20.0	+43.7
Germany (DAX)	4,138.0	4,139.9	2,203.0	+ 2.0	–48.7	+43.1	+71.3
Italy (BCI)	1,300.7	1,304.9	959.4	+ 1.6	–40.4	+19.1	+42.7
Japan (Nikkei 225)	11,002.4	11,161.7	7,607.9	+ 1.3	–71.7	+28.2	+41.8
(Topix)	1,070.4	1,105.6	770.6	+ 1.2	–62.9	+26.9	+40.3
Netherlands (AEX)	357.5	357.6	218.4	+ 2.9	–49.0	+10.8	+32.6
Spain (Madrid SE)	840.9	840.9	576.8	+ 0.9	–26.6	+32.6	+58.8
Sweden (Affarsvarlden Gen)	197.2	199.8	127.8	+ 0.8	–50.7	+35.8	+62.1
Switzerland (Swiss Market)	5,685.2	5,698.4	3,675.4	+ 1.1	–32.4	+22.8	+36.0
United States (DJIA)	10,623.6	10,623.6	7,524.1	+ 0.8	– 9.4	+27.4	+27.4
(S&P 500)	1,147.6	1,147.6	800.7	+ 1.5	–24.9	+30.4	+30.4
(NASDAQ Comp)	2,142.5	2,148.0	1,271.5	+ 1.5	–57.6	+60.4	+60.4
Europe (FTSE Eurotop 300)*	993.4	993.4	682.7	+ 1.4	–41.7	+15.9	+38.8
Euro area (FTSE Ebloc 100)*	866.8	868.6	565.7	+ 1.6	–44.1	+20.7	+44.5
World (MSCI)†	1,072.5	1,072.5	710.8	+ 1.2	–26.0	+35.4	+35.4
World bond market (Citigroup)‡	609.7	614.9	518.6	– 0.5	– 0.8	+16.1	+16.1

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms. ‡Citigroup World Government Bond Index, total return, in $ terms.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Trade, exchange rates and budgets

Jan 22nd 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2003	2004	Exchange rate trade-weighted† 1990=100 Jan 21st	year ago	Currency units per $ Jan 21st	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2003‡
Australia	− 14.9	Nov	− 27.2	Q3	− 5.9	− 5.2	89.7	75.2	1.30	1.71	2.37	1.64	1.21	0.8
Austria	− 0.6	Oct	− 0.1	Nov	− 0.1	− 0.1	102.8§	101.1	0.80	0.93	1.45	–	0.74	-1.3
Belgium	+ 19.8	Nov	+ 9.9	Sep	+ 4.4	+ 4.4	102.9§	100.4	0.80	0.93	1.45	–	0.74	0.2
Britain	− 73.5	Nov	− 36.1	Q3	− 1.9	− 1.9	102.8	103.2	0.55	0.62	–	0.69	0.51	-2.9
Canada	+ 41.1	Nov	+ 16.7	Q3	+ 1.9	+ 1.5	88.1	76.7	1.29	1.53	2.34	1.62	1.20	1.0
Denmark	+ 9.9	Nov	+ 5.9	Nov	+ 2.9	+ 2.7	107.0	104.5	5.93	6.95	10.8	7.45	5.52	0.8
France	+ 4.6	Nov	+ 20.3	Nov	+ 1.3	+ 1.3	106.3§	103.4	0.80	0.93	1.45	–	0.74	-4.0
Germany	+142.6	Nov	+ 56.2	Nov	+ 2.4	+ 2.6	103.8§	100.4	0.80	0.93	1.45	–	0.74	-4.1
Italy	+ 3.4	Oct	− 17.7	Oct	− 1.1	− 1.0	75.8§	73.7	0.80	0.93	1.45	–	0.74	-2.7
Japan	+102.5	Nov	+132.0	Nov	+ 3.0	+ 3.0	136.1	132.0	107	118	195	135	–	-7.4
Netherlands	+ 32.6	Nov	+ 17.7	Q3	+ 2.9	+ 3.2	102.3§	99.5	0.80	0.93	1.45	–	0.74	-2.4
Spain	− 51.1	Oct	− 25.0	Oct	− 2.3	− 2.3	77.0§	75.3	0.80	0.93	1.45	–	0.74	0.1
Sweden	+ 17.9	Nov	+ 14.8	Q3	+ 4.6	+ 4.4	82.1	78.0	7.30	8.64	13.3	9.17	6.80	0.2
Switzerland	+ 6.2	Nov	+ 29.4	Q3	+10.8	+10.7	111.3	116.5	1.25	1.37	2.27	1.57	1.16	na
United States	−548.6	Nov	−541.7	Q3	− 5.0	− 5.3	94.4	108.8	–	–	1.82	1.26	0.93	-4.9
Euro area	+ 84.2	Nov	+ 42.1	Oct	+ 0.4	+ 0.6	92.4	85.8	0.80	0.93	1.45	–	0.74	-2.7
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.4	Nov	+ 9.9	Nov	na	na	81.6§	79.3	0.79	0.93	1.44	–	0.74	2.6
Greece	− 24.8	Oct	− 10.7	Oct	na	na	59.4§	58.2	0.79	0.93	1.44	–	0.74	-1.6
Iceland	− 0.2	Nov	− 0.4	Q3	na	na	92.9**	91.9	70.0	79.2	127	87.9	65.2	-1.0
Ireland	+ 38.6	Oct	− 2.1	Q3	na	na	94.5§	89.8	0.79	0.93	1.44	–	0.74	-1.0
Luxembourg	− 3.4	Oct	+ 2.0	Q3	na	na	102.9§	100.4	0.79	0.93	1.44	–	0.74	-0.3
New Zealand	− 1.8	Nov	− 3.3	Q3	na	na	104.1	95.5	1.49	1.84	2.70	1.87	1.39	2.6
Norway	+ 28.1	Dec	+ 28.4	Oct	na	na	94.2	107.1	6.78	6.91	12.3	8.52	6.32	9.8
Portugal	− 13.0	Oct	− 8.1	Oct	na	na	93.2**	91.1	0.79	0.93	1.44	–	0.74	-2.9

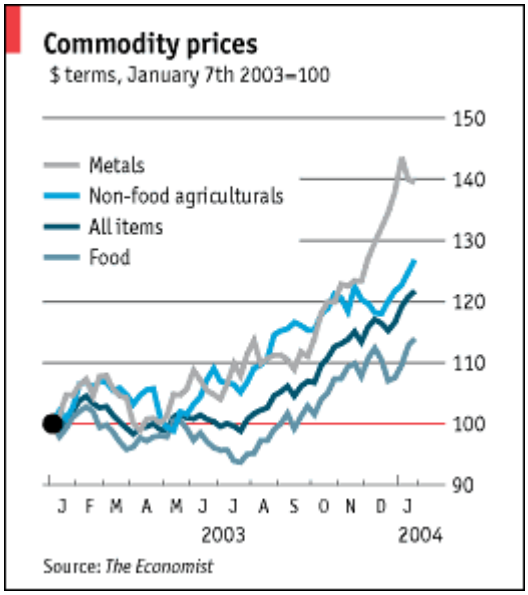
*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, November average. ‡OECD estimate.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Commodity prices

Jan 22nd 2004
From The Economist print edition

Our dollar-based all-items index rose by nearly 20% in 2003, thanks partly to Chinese demand for raw materials. Nickel prices doubled. Grains and soya prices rose as American stocks fell.



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Jan 22nd 2004
From The Economist print edition

China's economy grew by 9.9% in the year to the fourth quarter, and its annual growth rate of 9.1% in 2003 was the highest since 1997, according to official statistics (which many analysts believe are overly optimistic). Industrial output surged by 18.1% in the year to December. **Taiwan's** industrial output rose by 12.4% in the same period, more than twice as fast as forecast.

Poland's industrial output rose by 13.9% in the year to December, up from 9.2% in the year to November.

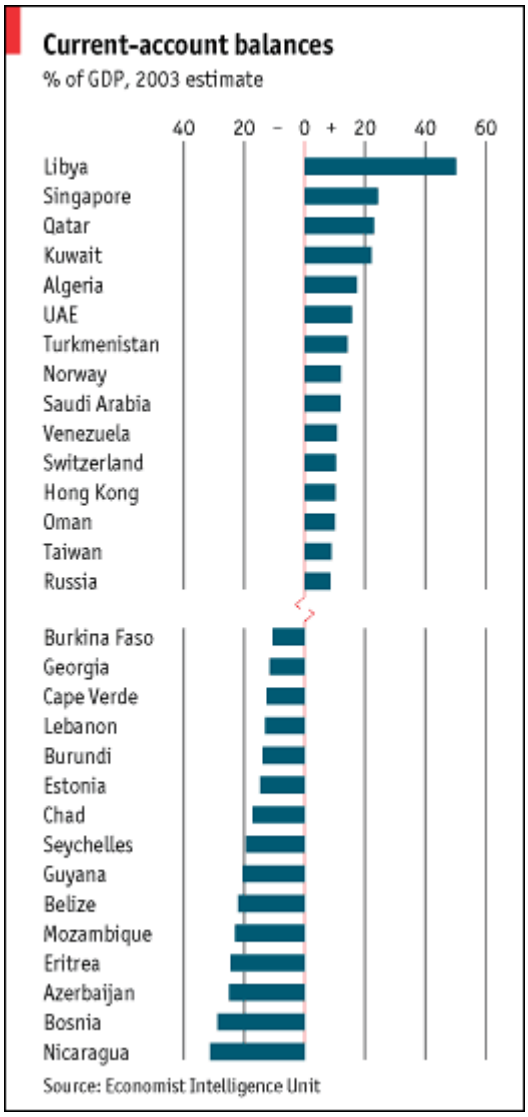
Peru's economy grew by 0.9% in the year to November.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Current-account balances

Jan 22nd 2004
From The Economist print edition

Foreign-exchange traders are mesmerised at the moment by America's big current-account deficit, worth 5% of GDP, but several developing countries have much larger deficits. Nicaragua, for example, ran a deficit of over 30% of GDP in 2003. In contrast, oil-producing countries chalked up big surpluses thanks to the continuing high price of oil. Libya headed the league with a surplus worth 50% of GDP. Some Asian economies, notably Singapore, also ran substantial surpluses last year.



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economy

Jan 22nd 2004
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.9	Q4	+18.1	Dec	+ 3.2	Dec	+22.9	Nov	+35.4	2002	406.0	Oct
Hong Kong	+ 4.0	Q3	– 9.2	Q3	– 1.9	Dec	– 8.0	Nov	+16.7	Q3	118.4	Dec
India	+ 8.4	Q3	+ 7.4	Nov	+ 3.1	Nov	–13.8	Nov	+ 2.3	Q3	96.6	Dec
Indonesia	+ 3.9	Q3	+ 4.7	Jul	+ 5.1	Dec	+26.8	Nov	+ 8.1	Q2	33.8	Nov
Malaysia	+ 3.5	Q3	+11.7	Nov	+ 1.2	Dec	+19.3	Nov	+11.9	Q3	44.0	Nov
Philippines	+ 4.4	Q3	– 3.9	Oct	+ 3.1	Dec	– 1.7	Nov	+ 3.4	Sep	13.4	Dec
Singapore	+ 3.7	Q4	+ 7.7	Nov	+ 0.6	Nov	+16.2	Dec	+25.6	Q3	96.3	Dec
South Korea	+ 2.3	Q3	– 3.9	Nov	+ 3.4	Dec	+14.4	Dec	+ 9.8	Nov	150.3	Nov
Taiwan	+ 4.2	Q3	+12.4	Dec	– 0.1	Dec	+17.0	Dec	+28.8	Q3	206.6	Dec
Thailand	+ 6.5	Q3	+ 7.4	Nov	+ 1.8	Dec	+ 4.5	Nov	+ 8.1	Nov	40.2	Nov
Argentina	+ 9.8	Q3	+13.0	Nov	+ 3.7	Dec	+16.6	Nov	+ 8.9	Q3	14.1	Dec
Brazil	– 1.5	Q3	+ 0.3	Nov	+ 9.3	Dec	+24.8	Dec	+ 3.7	Nov	54.4	Nov
Chile	+ 3.0	Q3	+ 1.5	Nov	+ 1.1	Dec	+ 2.9	Dec	– 0.3	Q3	15.9	Dec
Colombia	+ 4.0	Q3	+ 2.3	Oct	+ 6.5	Dec	– 0.2	Oct	– 1.6	Q3	10.5	Dec
Mexico	+ 0.4	Q3	– 0.3	Nov	+ 4.0	Dec	– 5.6	Nov	–10.5	Q3	57.3	Nov
Peru	+ 0.9	Nov	+ 0.7	Oct	+ 2.5	Dec	+ 0.6	Nov	– 1.2	Q3	9.6	Nov
Venezuela	– 7.1	Q3	– 4.8	Oct	+27.1	Dec	+14.0	Q3	+ 8.9	Q3	14.2	Sep
Egypt	+ 3.1	2003†	+ 4.2	2002†	+ 5.2	Oct	– 6.0	Jul	+ 3.3	Q3	14.4	Dec
Israel	+ 2.8	Q3	– 4.9	Oct	– 1.9	Dec	– 6.0	Dec	– 0.2	Q3	26.1	Dec
South Africa	+ 1.6	Q3	– 3.8	Nov	+ 0.4	Nov	+ 2.0	Nov	– 1.3	Q3	6.5	Nov
Turkey	+ 4.8	Q3	+ 3.9	Nov	+18.4	Dec	–20.9	Oct	– 5.6	Oct	31.3	Nov
Czech Republic	+ 3.4	Q3	+ 4.8	Nov	+ 1.0	Dec	– 2.4	Nov	– 7.8	Q3	27.0	Dec
Hungary	+ 2.9	Q3	+ 9.7	Nov	+ 5.7	Dec	– 4.3	Nov	– 5.0	Nov	12.8	Dec
Poland	+ 3.9	Q3	+13.9	Dec	+ 1.7	Dec	– 9.5	Nov	– 2.9	Nov	32.6	Dec
Russia	+ 5.7	Q3	+ 7.1	Nov	+12.0	Dec	+58.9	Nov	+39.1	Q4	73.2	Dec
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 4.6	Q3	+ 9.1	Oct	+ 1.1	Dec	– 1.9	Nov	– 1.5	Q3	1.1	Nov
Latvia	+ 7.3	Q3	+ 1.0	Nov	+ 3.6	Dec	– 2.0	Nov	– 0.9	Nov	1.4	Nov
Lithuania	+ 8.4	Q3	na		– 1.3	Dec	– 2.4	Nov	– 1.1	Q3	3.0	Nov
Slovakia	+ 4.2	Q3	+ 4.1	Nov	+ 9.2	Dec	– 0.6	Nov	– 0.8	Sep	10.9	Nov
Slovenia	+ 2.3	Q3	+ 2.4	Nov	+ 4.6	Dec	– 0.6	Sep	nil	Nov	8.0	Oct
Pakistan	+ 5.1	2003†	+ 9.9	Aug	+ 5.4	Dec	– 1.3	Dec	+ 3.6	Q3†	10.8	Nov
Saudi Arabia	+ 1.0	2002	na		– 0.9	Sep	+41.8	2002	+11.9	2002	24.5	Nov

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Financial markets

Jan 22nd 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jan 21st		Dec 31st 2002	
	Jan 21st	year ago	Jan 21st	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	15.0	na	1,677.3**	+0.5	+ 18.2	+ 18.2
Hong Kong	7.77	7.80	14.1	0.15	13,750.6	+3.2	+ 47.5	+ 48.1
India	45.4	47.9	82.4	4.24	5,758.2	−7.0	+ 70.5	+ 80.3
Indonesia	8,405	8,855	15,274	8.44	776.3	+2.6	+ 82.7	+ 94.5
Malaysia	3.80	3.80	6.91	3.03	824.7††	+1.1	+ 27.6	+ 27.6
Philippines	55.5	53.7	100.9	7.25	1,560.8	+2.3	+ 53.3	+ 47.3
Singapore	1.70	1.73	3.09	0.75	1,889.6	+1.6	+ 40.9	+ 43.9
South Korea	1,189	1,177	2,160	4.24	861.4††	+1.4	+ 37.3	+ 37.0
Taiwan	33.6	34.5	61.1	1.15	6,269.7**	−0.1	+ 40.8	+ 45.7
Thailand	39.0	42.7	70.9	1.34	766.7	−3.0	+115.1	+137.5
Argentina	2.89	3.07	5.26	4.19	1,223.8	+1.8	+133.1	+171.2
Brazil	2.85	3.50	5.17	16.30	23,301.8	−0.4	+106.8	+157.2
Chile	566	730	1,029	2.16	7,154.9	−1.7	+ 42.5	+ 81.3
Colombia	2,741	2,951	4,981	7.99	2,593.7	+6.9	+ 61.2	+ 68.6
Mexico	10.9	10.8	19.9	4.71	9,427.8	+2.8	+ 53.9	+ 47.1
Peru	3.46	3.50	6.29	2.29	2,795.2	+2.2	+100.8	+103.9
Venezuela	3,180§	1,922	5,779	20.04	28,687.8	+10.9	+257.9	+ 56.1
Egypt	6.16	4.63	11.19	6.89	13,593.9	+8.0	+153.1	+ 90.2
Israel	4.43	4.89	8.04	1.61	564.4	−0.2	+ 69.8	+ 82.2
South Africa	7.14	9.00	13.0	7.95	10,912.0	−0.3	+ 17.6	+ 41.3
Turkey	1,332,000	1,673,000	2,420,510	23.00	18,899.9	+0.4	+ 82.3	+127.1
Czech Republic	26.0	29.7	47.3	2.06	688.2	+1.7	+ 49.4	+ 72.5
Hungary	209	233	379	12.47	9,637.7	+0.7	+ 23.6	+ 33.2
Poland	3.73	3.90	6.78	5.47	22,137.2	+0.6	+ 54.1	+ 58.3
Russia	28.8	31.8	52.3	14.00	604.6‡	+1.6	+ 51.7	+ 68.4
EMF (MSCI)*	1.00	1.00	1.82	na	465.5	+0.3	+ 59.4	+ 59.4
EMBI+†	1.00	1.00	1.82	na	302.5	nil	+ 32.2	+ 32.2

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms. § Floating exchange rate. **Jan 16th. ††Jan 20th.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.